Case Study 1

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**Assignment questions**

*Answer the following questions in detail. Use as much reference material as possible (e.g. the reading material provided by INSOL and/or your own library) to explain and enrich your answers.*

1. What were in your opinion the causes of financial distress at Flow Management (see e.g. Mellahi & Wilkinson, 2004)? Could the financial distress have been prevented? If yes, explain how. If no, why not?

Flow Management is in continuous financial distress. Causes are various. We can consider dividing the causes into various factors

As per Mellahi & Wilkinson there are various reasons for the organizational failure, which may be either Internal or External

I have deliberated on the internal factors into the below four components.

**Internal factors**

1. Incompetency of Management

2. Operational Causes.

3. Financial Causes/ or Impropriety

4. Intentional and Unintentional Causes

1. Incompetency of Management

*Attempts by a long-tenured and homogeneous management team were ineffective because managers failed successfully to diagnose the causes of failure.*

Here the researchers are deliberating that management team failed to identify the causes of failure and failed to diagnose the failure on a continuous basis or on consistent basis. This is the collective failure of the management. The organization would be giving the indications about the factors which were affecting the organization. The management would have ignored for various reasons including that they know their job, it can be handled, it is not a priority now, it does not fall in my jurisdiction but actually another manager has to take call and actions. Particularly if the succession takes place in small organisation, the failures or negatives are very high.

*Another instance, management tried to increase efficiency through tactical changes such as cost cutting, when the firm’s weak strategic position was the cause of the failure.*

*A significant body of research suggests that, when organizations face an external threat such as a crisis, new managers tend to see the cause of failure as internal and controllable. In contrast, longer-tenured top managers’ perceptions of the causes of organizational crisis differ from those of new managers, and this influences the manner in which they deal with the crisis.*

In this situation the Flow Management is addressing a totally different problem. Hence a repeated failure of their plans and tactics. Rather they have not identified the root cause of the problem. Over and above, they are addressing few other issues in the organization, which are issues but rather not the main issues. These issues could have been as well handled. But the main issues (The Strategic Concerns) were unattended and that will become a major cause in the downfall of the organization.

*A long-tenured top-management team may cause organizational failure under conditions of fundamental environmental transformation by becoming entrenched and unreceptive to change.*

*In particular, longer- tenured top managers tend to attribute failure to external, uncontrollable and temporary causes. As a result, they tend to ignore internal causes of failure and subsequently exacerbate the problem. In particular, research suggests that longer-tenured top management is likely to be associated with increased rigidity and commitment to standardized practices.*

A management which is not visionary, which cannot visualize what is going to happen to the organization in next 10 years is actually missing out on the fundamental environmental change that is taking place in the environment and the perception of customers is going trigger a strategic organizational crisis. Particularly the technological changes which the environment was going through the management were not visionary enough to evaluate and take course corrective actions for the benefit of the company. To name few companies which failed to understand the environment were Kodak, Nokia Blackberry, Yahoo, IBM, Motorola and the like. Here the managers tend to give reasons which they feel are beyond their control. Though they are in the organization for longer period of time, they are fully involved in addressing the non-core issues or rather address the core strategic issue.

Operational Causes :

The company is restructuring the organisation. It has make efforts to sell a fleet. Retrench Exess man power and tried to save the cost on repairs of these cars and bring in efficiency and profitability in the organisation. These are few of the operational causes which have contributed to losses.

The causes of financial distress

* *large management bonuses (€ 3 million) have been wrongfully issued (concerning salaries of the CEO and CFO of Flow Management Holding BV);*
* *A contingency gain relating to three years has been received in 2012 and has been wrongfully booked as a result in 2012. A negative correction of € 1.6 million must be made;*
* *In 2012, in anticipation of book profit (‘paper gain’) to be realized in 2013, a € 2.8 million book profit is made. This book profit was neither realized in 2012 nor in 2013;*
* *The 2013 loss is the result of the basic principles used in the cost price calculation deviating from reality (as a result of a ‘formula error' in a spreadsheet, it emerges later). Since they failed to periodically check the real costs against the results of the cost price calculation, the prices charged were too low, resulting in a loss*.
1. No Proper, prudent accounting No proper monitoring of accounts and reports We have seen a more of wrong accounting to deceive the stake holders by accounting contingent gain and booking unrealized profit which had to be rectified later. The thoughts to be pondered over here are whether these actions were intentional or un intentional. By the analysis we can give more weightage to the fact that management were deliberate to make such wrong actions to show better results and to cover up all their failures. Finally, when the crisis arouses, they realized that they were trying to hold on to the tail of the tiger and had to let go it.
2. As management they had no proper idea of the product pricing and product costing because of the wrong cost price calculation. This also showed how incompetent even the accounting and product costing team were, where in a formula error created wrong costing of the product, there by wrong pricing of the product and finally leading to the loss of the product. These factors of higher costs and no proper pricing of the product can also be deliberated with failure on the part of the management in competencies. Worst is they did not realize these mistakes till the crisis raised.
3. Failure of the Bankers or the generosity of the bankers: The funders of the company I feel did not find the necessity of investigating into the affairs of the company. They could have felt the nerves of the company when all this accounting entries were made and also when the company was declaring consistent losses. They must have not waited so long to hold the company and the management into account.
4. Non-Commitment of the Shareholders: The shareholders did not show much commitment towards raising capital or infusing capital when the company was in dire need. This again shows their confidence in running the company as a going concern. All the results were showing that the company was not doing well and there was an immediate requirement of the funds and intervention of the shareholders, which shareholders failed to do.
5. Operational In Efficiencies: Company must have good EBITDA margin; else the company is always in the cash loss and can never recover irrespective of the huge number of customer base or fullest utilization of its fleet. The company must always consider the improvement of operational efficiency and bring about cost reduction consistent increase in prices considering the inflation and have a good EBITDA Margin. This will help to avoid cash losses and always there will be chances of making a turnaround of the company in case company slips into losses. There will be ample opportunity for a turn around. Particularly in the present case when the company proposed selling off of its fleet and also reducing its man power, again which reflects its present situation of operational inefficiency.

*On 20 December 2013 the (adjusted) actual results for 2011-2013 are announced. They have been listed below.*

|  |  |
| --- | --- |
| *In € million* | ***Net profit*** |
| *2011* | *9.4* |
| *2012* | *-/- 6.1* |
| *2013* | *-/- 36.4* |

*The total loss turns out to be even higher than stated on 1 December 2013. Solvency, at 0.1%, is virtually zero. It is concluded that there is enough cash to fulfil the current obligations until the end of April 2014.*

There is operating losses and there is no cash inflow. Working capital management is becoming challenging day by day losses mounting. We need to consider better options.

*These results show that the bankers have to micro manage the company reports and hold management to account for not working towards the targets or rather not achieving the targets. Whatever the new commitments the company is reposing on the bankers it is unable to justify in reality. The company is displaying a sense of no hope with the Bankers.*

**WRONG MIS**

*The main reason for these talks is that the reported pre-tax profit until September 2013 of € 8 million really turns out to be a loss of € 5.4 million. In addition, faults have been found in the annual accounts of 2012. The result of € 3 million must be downgraded by € 8 million.*

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I feel, the company must come out clean and must make adjustment for all the impairment of assets and conclude the accounts. The way the MIS and accounts were drawn, as already discussed has created no confidence in the Financial Statements particularly with the Bankers. The way the pricing was done also reflected that the company had failed to understand its own basic operational accounting and mis reporting. Or rather the Business model what it was on paper itself was wrong.

The company’s MIS reporting to manage the company and to look into the financial modelling had to have at least following of the basic reporting, which in turn would have helped the management and the sales team to price the product prudently.

The company must focus on a pricing in terms of adjusted revenue per unit and adjusted costing per unit and try to achieve a reduction in the Non-Vehicle Debt levels.

Few Key Matrix the management must and should manage as a part of daily MIS reporting on a daily basis to avoid a financial crisis would be the following items***. (@source –Latest Hertz Financial Statements). As we know that the company had wrong formulae and cost workings impacting the final pricing and final profitability, the following information will add a huge value for the company to take timely decisions and avoid financial crises.***

1. Available Vehicle Days

Available Vehicle Days represents Average Vehicles multiplied by the number of days in a given period.

1. Average Vehicles ("Fleet Capacity" or "Capacity")

Average Vehicles is determined using a simple average of the number of vehicles in the fleet whether owned or leased by the Company at the beginning and end of a given period.

1. Depreciation Per Unit Per Month ("Depreciation Per Unit" or "DPU")

Depreciation Per Unit Per Month represents the amount of average depreciation expense and lease charges per vehicle per month, This Metrix will help management and investors to show how effectively the Company is managing the costs of its vehicles and facilitates comparisons with other participants in the vehicle rental industry.

1. Total Revenues

Total Revenues - This Metrix is important to management and investors as it represents a measure that facilitates comparisons with other participants in the vehicle rental industry.

1. Total Revenue Per Transaction Day ("Total RPD"or "RPD"; also referred to as "pricing")

Total RPD represents the ratio of Total Revenues to Transaction Days. This Metrix is important to management and investors as it represents a measure of changes in the underlying pricing in the vehicle rental business and encompasses the elements in vehicle rental pricing that management has the ability to control.

1. Total Revenue Per Unit Per Month ("Total RPU" or "RPU")

Total RPU Per Month represents the amount of average Total Revenues per vehicle per month. This Metrix is important to management and investors as it provides a measure of revenue productivity relative to fleet capacity, or asset efficiency.

1. Transaction Days ("Days"; also referred to as "volume")

Transaction Days represents the total number of 24-hour periods, with any partial period counted as one Transaction Day, that vehicles were on rent (the period between when a rental contract is opened and closed) in a given period. Thus, it is possible for a vehicle to attain more than one Transaction Day in a 24-hour period. This Metrix is important to management and investors as it represents the number of revenue-generating days.

1. Vehicle Utilization ("Utilization")

Vehicle Utilization represents the ratio of Transaction Days to Available Car Days. This Metrix is important to management and investors as it measures the proportion of vehicles that are being used to generate revenues relative to fleet capacity.

**External factors**

*Technology innovation turbulent demand structure due to brand switching by core customers, changes in consumer tastes, cyclical decline in demand, and strategic competition due to rivalry among existing competitors or new entrants.*

There might be external factors which the organizations fail to see as to what competitors are offering, what is the new taste a customer has a quest for, how our product is getting obsolete, better simpler and cheaper products are coming into the market. The Flow Management Company’s product life cycle is actually in its end state. Their competitors like M/s Hertz are already gone ahead with technological changes and changes in business Model. In this regard the Flow Management would have failed financially and as a business to realize, these external factors are going to have huge impact on the survival of the organization itself.

1. What are in general advantages and disadvantages of an out-of-court restructuring (workout) as compared to a formal bankruptcy procedure? More specific, what are the advantages versus disadvantages *in your country*?

An informal reorganization is understood to be a reorganization route which takes place outside the statutory framework—therefore, in the shadow of the law—with the objective of restoring the health of a company in financial difficulties within the framework of the existing legal entity. An informal reorganization consists primarily of business restructuring and financial restructuring.

The advantages of the Out of Court Restructuring

Flexibility as anything can happen. There are no rules and restrictions. It is less rigid. There will be consensus between all the stakeholders. The solutions can be tailor made in terms of moratorium, interest rates and also given an option for insertion of new clauses as the time progresses in the benefit of the restructuring.

Also, since the court is not involved all the deliberations happen in the conference room, without any public scrutiny.

The cost of the work out will be much lesser. The time is a big factor. All the stake holders will sit across and conclude the agreement. They will understand each other better and give the margins in their conversations to keep the company alive. The chances of the company recovering are much higher and much faster. The Corporate Debtor will be in the control of the company it becomes easier to the run the company efficiently as he knows the company better. For the company also the finance cost will be come lesser as per the compromise formula and it would be able to manage the finances better because of the reduction in the burden of finance cost. As in this case the chances of Liquidation are remote the value of the assets of the company will be much higher and much valuable as in case of in court restructuring. Where in the creditors might have to pitch in and manage the affairs of the company. The interest of the management would have become less as they might be of the opinion that they will be fighting a losing battle and they may not be getting back the company.

An informal approach will create hopes and Opportunity for the economy as the company will be in existence and there will be an eco-system which will survive because of the company being in existence.

Sometimes business decisions and actions may go wrong but that must not be a reason for giving the death knell to the company. An opportunity must be given to the company. It will be a course correction and do the job of giving a life to the organization and to the eco system.

In an informal approach the Management is still in control and will be running the company. They know the company better and it would be more appropriate for them to be at the helm of the affairs of the company.

Disadvantages

The Biggest disadvantage would negative impact on credit score. Since the company is going for out of court of settlement, financial creditors would have lost the confidence. And also the CIBIL rating will be downgraded. Hence future fund raising will be a challenge.

Hair cut creditors is a huge loss to the public money and bankers. It would amount to rewarding incompetent.

There is a big scope for trust deficit. The creditors, the eco system and various vendors will always have a suspicion on the company. They will have a strong approach towards the company and this may lead to increase in input cost and operational costs. The costs of interim financing will be high.

1. Were the turnaround/reorganization approaches as presented in the reading material (see e.g. Adriaanse & Kuijl, 2006, Pajunen, 2006, Sudarsanam, S, Lai, J., 2001, Schmitt, A., Raisch, S., 2013) applied in this case? If yes, explain in what way. If no, detail what in your opinion should have been done differently.

In the reading material presented the research scientists have deliberated on the various approaches methodologies analysis and results of all these studies. I have made an attempt to co relate these researches in our case presented.

**Jan Adriaanse and Hans Kuijl**

Both of Adriaanse & Kuijl have done research and brought our papers in Business restructuring and Financial Re structuring. They felt that out of the court and soft law approach would be more appropriate way of restructuring with both the stake holders seated across and arrive at a win win formula. This will help to restore the health of a company which will work within the paradigm of the legal framework.

They have deliberated as below.

Statutory legislation aimed at the deferment (or remission) of debt payments is introduced or relaxed in order to provide a fresh start for insolvent companies and legislators must particularly focus their attention on informal reorganization.

A turnaround approach primarily consists of

1. Business restructuring and
2. Financial restructuring.
3. **Business Restructuring according to the researchers consists of the following 4 phases.**
4. Stabilizing
5. Analyzing
6. Repositioning and
7. Reinforcing
8. Stabilizing

Actions to Increase the Cash Flow in the Short Term

Action

Cutbacks in expenditure

Optimizing the stock situation

Optimizing turnover times of the accounts

Description

Reducing the current expenses both in the field of costs

Selling off excessive stock, as well as reducing the stock (which creates both physical and financial space)

Quicker collection of receivables and/or period

In line with stabilizing the organization, the management has taken few steps to increase the cash flow in short term.

Cutting Expenditure

Here the company is considering retrenching 130 staff and also shelf off a fleet of 350 cars which will help to repay loans to the banks. This will add additional saving in car repairs. The total saving is expected to be 3.9 Million Euros. Further they have increased the prices which most of the customers have agreed will also help in increasing the cash flow for the company in short term which would also help them to mitigate the long-term obligations.

***These facts again represent the company has implemented few of the research materials as presented by the authors.***

1. Analyzing

Subject Matters within a Reorganization Plan

1. A strategic and financial analysis ex post to trace the causes of the negative state of affairs
2. An inquiry into the actual financial position and an assessment as to whether or not the company still offers sufficient basis for recovery
3. Proposed measures and the calculated effects thereof on long-term exploitation overviews and balance Projections
4. Cash flow projections in the short and long term from which it appears that the obligations entered into (And to be entered into) can be performed
5. Cash flow projections which show a future improvement in the liquid assets

In line with the next phase of analyzing the company has appointed a firm to support and analyze and investigate into the affairs of the company.

The company has taken actions and evaluated the financial results of the company which is likely to yield amount

The company has appointed one accounting firm to initiate inquiry into the actual financial position.

Further the company has announced and appointed a Chief Restructuring officer to help in restructuring process.

There has also been a proposal of appointing a new CFO into the management.

CEO has also got replaced during 2014, shows that the management and the bankers are serious about making the company’s turnaround.

***These facts again represent the company has implemented few of the research materials as presented by the authors.***

**Further in terms of the proposed measures and the calculated effects thereof on long-term exploitation overviews and balance projections the following action points have been taken place.**

* the strategy must be focused on increasing turnover by itself, in combination with large cutbacks; which the Flow Management has done successfully.
* the entire business mix (product-range) will be evaluated and reassessed; which the company has tried to re price and shelve off the assets.
* The shares of the companies outside the Benelux-countries1 will be sold off, as well as some (non Benelux) foreign branches (non-legal entities) controlled by Flow Management Work BV.

Measures to Restore Long-Term Profitability

* Adjusting strategy and marketing cutting overhead costs dismissing excessive personnel
* Rationalizing the product assortment improving purchasing processes
* Improving management information systems Improving working capital and cash flow management closing loss-making business units
* To improve the working capital the company is planning to infuse capital from share holders
* Capitalize (excessive) fixed assets
* Selling (profitable) operations which are not part of the core activities

In case of financial restructuring, we have seen a few stringent disciplines taken up. First there has been a talk of increase in prices and the same has been communicated to many of the loyal customers. They have agreed. Others are to be communicated. Which they are likely to be communicated shortly and agreed upon

Another case of financial restructuring includes selling off of a fleet of 350 cars

Further 130 staff members have been retrenched to yield an annual saving of 3.3 Euros.

Further the Equity holders have been asked to infuse the capital further to make the solvency rate of 5%.

To improve the working capital the company is planning to infuse capital from share holders

In the very first phase the equity shareholders have been asked to pay off the equity capital so as to make a good solvency ratio.

Further the Shareholder has deposited 10 million Euros as unsecured loan and proposes to deposit another 27.5 million euros Loan.

In June 2014 the Shareholder commits further 10 million Euros and deposit 25 million Euros.

***These facts again represent the company has implemented few of the research materials as presented by the authors.***

1. Reinforcing

In addition, this can (also) be achieved by transferring the company to another (healthy) company (as a result of which future payments can be guaranteed).

In line with the concept of Reinforcing, the stakeholders on July 15th agreement the plan is to consider the following:

1. All operating companies of Flow Management Holding BV are to be accommodated in a shell subsidiary, called Flow Management II BV;
2. The shares in Flow Management II BV are transferred to the consortium of banks (A, B, C, D) which has financed the original working capital of Flow Management Work BV, as well as to a number of board members (including the CRO);
3. Flow Management Holding BV will be liquidated in an undisclosed manner. All claims against this BV will be cancelled by the banks and the shareholder of Flow Management Holding BV;
4. Hence there will be finally a reinforcing the plan by liquidating the problematic company and transferring the business to a health company.

***These facts again represent the company has implemented few of the research materials as presented by the authors.***

1. **Financial Restructuring (RESOLVING FINANCIAL DISTRESS)**

Financial Restructuring

An organization which undergoes re organization, the process cannot be complete without a financial restructuring. The financial statements would be in a position of dis array or in a position of no hopes. Huge losses, operating in efficiencies, huge obligations towards assets will give thin hopes towards repayment of obligations. Hence a financial restructuring is required, as the company will not always be able to clear away the “burden” from the past with its own current cash flows.

The various measures that can be taken during Financial Restructuring are as under.

* Reducing the repayment obligations and/or reducing current debts
* Reducing interest obligations
* Deferring repayments
* Deferring interest obligations
* Converting risk-avoiding capital into risk-bearing capital (debt-equity swap)
* Generating new risk-avoiding financing
* Generating new risk-bearing financing (e.g., in the form of a partial or complete takeover)

Financial restructuring is mainly aimed at deferring repayments and proposing workout agreements with remission.

In the company with respect to financial restructuring we have seen a few disciplines coming in the way. First there has been a talk of increase in prices and the same has been communicated to many of the loyal customers. They have agreed. Others are to be communicated. Which they are likely to be communicated shortly and agreed upon

Another case of financial restructuring includes selling off of a fleet of 350 cars

Further the shareholders have had various obligations at various points of time during this journey of restructuring which was deliberated earlier have been reinforced again here below

In the very first phase the equity shareholders have been asked to pay off the equity capital so as to make a good solvency ratio.

Further the Shareholder has deposited 10 million Euros as unsecured loan and proposes to deposit another 27.5 million euros Loan, provided there is an standstill agreement which is signed. This can be considered as the risk avoiding capital. Further the initiation of a new scheme where the complete company will be transferred to a shell company is a kind of risk free capital.

In June 2014 the Shareholder commits further 10 million Euros and deposit 25 million Euros.

There has been a standstill agreement which gives better repayment obligations and reduction of interest rates.

**K. Pajunen**

K Pajunen has done extensive research on various impacts of shareholders in the organization in particular management of stakeholders in organizational survival.

(1) What kinds of stakeholders are the most influential in the organizational survival?

(2) How we should handle these stakeholders?

In our present case we did not have a powerful stake holder who could drive the company. Rather the company cannot much rely on the present shareholders. The shareholders simply had invested in the company and had relied on professional members to run the company. Hence their influence in the organizational structure was not evident or influential. Their network and their influences were limited to create a breakthrough in the organization.

Hence they were pure investors who had interest and love in the business and never wanted the organization to die. They were willing to infuse more money into the company, even after knowing the fact that their money were going into deep holes and chances of recovery were less.

A stakeholder has power over the focal organization if the focal organization is more dependent on the stakeholder than stakeholder is on the focal organization. Stakeholders may control the use of resources critical to the operation and survival of the organization, possess means by which to influence organizational behaviour, control access to and allocation of critical resources, or regulate the possession of resources.

The Other set of stake holders (In Indian Context All the claimants are treated as STAKEHOLDERS) in terms of financers are kind of jittery position as they are not seeing much results on various options proposition they are doing. They too are not much networked or much influential as they are relying on the management to create miracles and pull out the company from Bankruptcy. Their influence and differences is evident from the fact that they are not in congruent with the way forward. Bank A & B are unable to convince Bank C & D.

**Various Propositions Stakeholder Management in Organizational Survival**

Proposition 1: The more secure the continuing support of governing stakeholders in an existence-threatening crisis, the more probable is organizational survival.

Bank A & B are somehow unable to convince C & D to hang and support the going concern opportunity of the company. That is critical for the survival of organization. Further infusion of capital by the present equity holders is again an immediate requirement to overcome the existential crises of the company. Getting into a settlement agreement and bringing in moratorium impact also will help the company for its survival. Hence it is very important to secure the support of all the stakeholders in this situation. Else the company will be probably end up in Bankruptcy.

Proposition 2: In an existence-threatening crisis, frequent and open communication between managers and governing stakeholders will tend to enhance (rather than undermine) the continuing support of those stakeholders and increase (rather than decrease) the probability of organizational survival.

There has been open discussion between the management and stakeholders they are trying to get the standstill agreement and also trying to get the shareholders infuse capital to have a healthy solvency ratio. Further they have agreed to churn the management in terms of new CEO, CFO, CRO and the like. The management is expecting a good standstill agreement and concessions from the bankers. These continuous conversations have helped good chances of organizational survival.

Proposition 3: In an existence-threatening crisis, personal relationships between man- agers and governing stakeholders will tend to enhance (rather than undermine) the continuing support of those stakeholders and increase (rather than decrease) the probability of organizational survival.

I agree with this statement as a personal rapport is always good. It is like a family come together and understanding and bonding will help the survival or existence of family. By agreeing to the fact that all are individuals with individualist ideas, however the quest and desire of keeping family together and moving on will help their existence as a family similar is with the organization. With personal understanding and bonding and with good equations they will help survive organizations.

Proposition 4: In an existence-threatening crisis, management’s unlocked brokerage position between governing stakeholders will tend to enhance (rather than undermine) the continuing support of those stakeholders and increase (rather than decrease) the probability of organizational survival.

I agree even to this fact that the management must be forward looking rather than sticking to their point of view to help the stake holders to pull out from the dangers of organizational existence. If not all will be stuck at the same point and the objective of survival will be lost with a locked position and the confidence of the governing stakeholders will be minimal on each other which will ultimately reflect on the survivability of the organization.

Proposition 5: In an existence-threatening crisis, consensus on long-term goals among governing stakeholders will tend to enhance (rather than undermine) the continuing support of those stakeholders and increase (rather than decrease) the probability of organizational survival.

I agree to this fact, all the stakeholders have worked out and reached out to many understandings and signed agreements to on various occasions. Created and recreated various scenarios and concluded on few plans and objectives. When these were not turning out as desired, they did a course corrections and inserted new objectives and goals. Hence there were deliberations but ultimately they had consensus on the final goals which helped them to achieve the ultimate objective of organizational survival.

**SUDARSANAM**

**Mr. Sudarsanam focused on corporate Turnaround in particular how the Retrenchments lead to recovery of the corporate and helped the financially distressed units caused a Turnaround.**

Mr. Sudarsanam was of the opinion that the Managers refrain from actions that may contribute to turnaround but hurt their own self- interest. So self-interest in a short term gain causing damage to the organization on the long run. He felt that the shareholders and the financers are in good position to resolve the situation and exploit the resource to its best or maximum. Inside of this strength or position the bankers can take action to reschedule the loans and give extra credit facilities for the corporate which is pretty essential to survive as a going concern. Sometimes the financiers will have no choice and may have to go ahead giving these facilities and giving a reschedule option which otherwise will be a death bell of the organization and which in turn will lead to severe social and economic conflicts.

Sudarsanam was of the opinion that recovery and non-recovery firms adopt very similar sets of strategies following financial distress but their strategic choices diverge over time, with recovery firms choosing investment and acquisition to lead them out of trouble whereas non-recovery firms are more internally focused on operational and financial restructuring

In the present case the shareholders were keen to invest only upon the support of the bankers. They were unwilling to risk their bridge capital until the standstill agreement had been signed. It could be termed as stakeholders bring forth their own interest rather than the companies.

Inside of corporate restructuring there will be managerial restructuring operational restructuring

In Managerial restructuring banks and creditors will continue financial support only if they are confident that the management team can manage the crisis in hand. A change in top management is tangible evidence to bankers, investors and employees that some- thing positive is being done to improve the firm’s performance, even though the cause of poor performance may have been beyond management’s control

Operational restructuring comprises cost reduction, revenue generation and operating- asset reduction strategies to improve efficiency and margin by reducing direct costs and slimming overheads

Operating-asset reduction refers to business- unit level sale, closures and integration of surplus fixed assets such as plant, equipment and offices, and reduction in short-term assets such as inventory and debtors. This is driven by the need to enhance the efficiency of the firm’s current operations through improved asset utilization at the operating level

In the out of court structure the banks are willing to take risk and provide additional debt in order to improve the chances of success.

*Restructuring, control factors and corporate turnaround*

It appears that non-recovery is not due to managerial inertia in non-recover. Yet they fail to recover. One possible reason is that these managers are not effectively implementing their chosen strategies. It appears that recover managers are not only doing the right things but also doing them right.

**An examination has been made of the factors that determine the success of a rescue operation**

* active attitude by management and shareholders with regard to the informal reorganization;
* involvement of important interested parties (financiers) in the reorganization process;
* adequate and speedy reorganization of the business operations (preferably with the help of third parties);
* transparency (towards financiers) with regard to the financial situation and the intended informal reorganization;
* injection of risk-bearing capital (equity)

All the above factors deliberated by sundaresan have been tried out in the case study, where in the management and bankers have reached out to each other and tried various options for restructuring and re organization. They have hired outside agencies to help them arrive at a resolution and also analyze the causes of failure. They have agreed upon to choose a Chief Restructuring Officer. Overall the situation looks transparent and confidence building. The shareholders are willing to infuse further capital for good solvency ratio and the bankers are willing to provide extended timeline and restructure the finance.

As in the words of Sundaresan, a good relationship between the company and its primary stake- holders (usually, banks and/or primary suppliers/vendors) appears to be vital. Informal reorganizations only have a chance of success when these interested parties can be convinced of the (future) viability of the company and the abilities of management. A transparent approach to the problems—often with the help of specialized advisors in the field of business restructuring, in combination with realistic prognostications—are important in this respect.

**Summary and conclusions**

Mr. Sundareshan has deliberated on how firms faced with potential bankruptcy avoid that fate and turn themselves around is of profound importance to those firms, their stakeholders and the economy at large

He has identified the major difference between recovery and non-recovery firms by focussing on ineffectiveness of restructuring in early years leads to more intensification of strategies. He has highlighted on the fact that the restructuring intensity is cumulated over the post-distress years, will not contribute to recovery.

1. Banks C and D seem to frustrate the process at a certain point. What could have been the (rational and/or opportunistic) reason(s) for them to behave like that? What would you have done in that situation in your role as advisor of the other two banks?

Option 1:

As said in the question the banks C and D are a frustrated lot and are trying to frustrate the process too. There may be various reasons including no confidence in the management, no hopes of the business getting revived. More than being rational or opportunistic it might be a conservative approach.

As discussed in question one where in the management has failed on many counts including fault reporting, incompetent accountants giving wrong product costing and pricing. Wrong MIs reporting, repeated failure to achieve the desired target, or positive financials, there is no hope in continuing the present situation. Further Bank C & D knows there have been many wrong contracts or camouflaged contracts, which cannot be executed. In case of liquidation Bank C and D know that they are going to give 100% haircut. Hence I feel their behaviour is in line with their thinking discussed above. Why extend the time line when one is clear about the results. Hence they wish to get out of this mess and book whatever losses. They have failed to monitor the company earlier and now they feel it is too late to salvage anything. At the end of the day this company is a time bomb which is likely to explode and Bank C & D do not want to risk it.

As an advisor in this situation of other two Banks (i.e. of Bank A & B) I will be thinking aloud and put them in inquiry mode to give exit option to Bank C & D. Buying them out at 20% discount might not be a good option. The frustration of Bank C & D is that in case of liquidation they are going to get 100% haircut. Hence a better discount can be bargained.

Option 2:

Since we are nearing the standstill agreement, since it is known that the last resort of going to liquidation is a risky and a losing proposition and a soft approach of giving another opportunity to the Debtor would be a good option. As there were already conversations that corporate restructuring in place. Equity holders are likely to infuse more funds and solvency ratio is going to be in good position, it would be a worthwhile try to give an opportunity to the corporate debtor. Further the subsidiaries are giving good hopes and delivering profits. Further the management is thinking of shelving few cars to cater to the working capital needs.

Option 3:

The Company is considering an option of CRO and restructure in on the cards. If the management shareholders and the strategy change it would be a worthwhile risk to be taken. The business model is a successful one, a tested one. This is the model which most of the countries and continents are turning towards. Many urban citizens prefer the present model and this business model is here to stay. One can and must consider being a part of this investment opportunity. Since the bankers have been supporting this company for quite some time, the real time has come to support them. With the corrections suggested, this restructured company is bound to give positive results and the management and the CRO to predict and project positive results. Hence it would be good option to put the trust and weight behind the company.

1. Which of the eight principles of the ‘Statement of Principles for a Global Approach to Multi-Creditor Workouts II’ can be found in the workout process of Flow Management (explicit or implicit)?

*A recently hired independent turnaround consultancy agency concludes that the company is viable, with a view to the market share and achieving the estimated turnovers*.

*Although, the banks are shocked by the entire company’s situation, legal action will not yet be taken against the company, pending the final report from the consultancy agency. It is concluded by the bankers ‘not to panic’. Moreover, it is decided that action must be taken jointly and in a controlled manner.*

From the above two paragraphs it is clear that the creditors have in principle come to a conclusion that they have understood that the company needs support. Hence the first principal is applicable. Further this standstill agreement cannot be against the rule of land. It has to be in complaint with the general philosophy of the land. Many countries have formulated their insolvency laws in line with UNCITRAL. Hence even the sixth principle can be implicitly applied to the question in place.

**FIRST PRINCIPLE:** Where a debtor is found to be in financial difficulties, all relevant creditors should be prepared to co-operate with each other to give sufficient (though limited) time (a “Standstill Period”) to the debtor for information about the debtor to be obtained and evaluated and for proposals for resolving the debtor’s financial difficulties to be formulated and assessed, unless such a course is inappropriate in a particular case.

**SIXTH PRINCIPLE:** Proposals for resolving the financial difficulties of the debtor and, so far as practicable, arrangements between relevant creditors relating to any standstill should reflect applicable law and the relative positions of relevant creditors at the Standstill Commencement Date.

*Early August 2014, and the banks conclude that the time has come for a ‘Go or No Go’ in respect of the question whether financing should be continued. Although, the banks as a group are not happy with the constantly changing information given by the company, they are content about Flow Management Holding BV’s new management (including the CRO) and they notice a slight result improvement due to the reorganization. They therefore decide to pursue a standstill agreement in the short term. Nevertheless, sale scenarios are drawn up as well as a liquidation scenario. These scenarios must have been drawn up no later than September / October. The 120- day standstill agreement is subsequently signed in the middle of August 2014.*

A standstill agreement is in place. The Bankers wish to support the company to turn around by giving them an opportunity. Hence the second principle is applicable

**SECOND PRINCIPLE:** During the Standstill Period, all relevant creditors should agree to refrain from taking any steps to enforce their claims against or (otherwise than by disposal of their debt to a third party) to reduce their exposure to the debtor but are entitled to expect that during the Standstill Period their position relative to other creditors and each other will not be prejudiced. Conflicts of interest in the creditor group should be identified early and dealt with appropriately.

*However, the profit that has been forecast for 2014 does not seem to be feasible. A loss of € 8.5 million is expected, but on the other hand there is an expected profit of € 30 million in 2015, although the ranges applied (positive/negative) are € 4 million and € 10 million respectively. Also based on the afore-mentioned, the banks (instigated by bank A) announce they want to appoint a*

*Certain person as CRO (‘Chief Restructuring Officer’) in the board of directors of Flow Management Holding BV, because she can be valuable in the restructuring process.*

Here the Banks and the company have decided to appoint a responsible person a single person to help the company to turn around and he is called the CRO. Hence the 4th principle is considered applicable.

**FOURTH PRINCIPLE:** The interests of relevant creditors are best served by coordinating their response to a debtor in financial difficulty. Such co-ordination will be facilitated by the selection of one or more representative co-ordination committees and by the appointment of professional advisers to advise and assist such committees and, where appropriate, the relevant creditors participating in the process as a whole.

1. Suppose it is not possible to convince other creditors to adopt the Statement of Principles in a given situation, are there any other possibilities for “soft law” to use (perhaps specifically in your country/region)? If yes, explain in what way. If not, do you see any alternative (informal) possibilities?

In our country a new law got enacted to deal with the insolvency matters which was coined as Insolvency and bankruptcy law 2016, it is called the insolvency and bankruptcy law 2019. Here the opportunity is given the company itself along with other good buyers to buy out the company and “bail out the Bankers”. In India this called as Corporate Insolvency Resolution Process. Here a court appointed administrator called the Insolvency Professional, gets the company valued and calls for bids. The Highest Bidder gets to hold the company or if there are no bidders the company will go for liquidation. In case the company goes for liquidation it is a bad thing for the economy, bad for the stakeholders who would have funded the company, it is bad for the promoters who would have put in a lot of efforts to bring the company to its present condition.

Another soft law has been brought into legislation. This is called prepack insolvency resolution process.

A pre-pack is **a way of resolving the troubles of creditors and owners of a distressed business.** Under a pre-pack resolution, creditors and owners of a business agree to sell the business to an interested buyer before going to the court to sanction the agreement.

**Pre-pack is preferred hybrid framework to resolve stress as a going concern, with minimum assistance of Government** – Pre-pack is an innovative corporate rescue method that incorporates the virtues of both informal (out-of-court) and formal (judicial) insolvency proceedings. Ever since it got enacted, this is the most preferred hybrid framework, as it empowers stakeholders to resolve the stress of a CD as going concern, with the minimum assistance of the State. The Process is fast, cost efficient, and effective in resolution of stress, much before value deteriorates, with the least business disruptions and without attracting the stigma attached with the formal insolvency process. It starts with an informal understanding, engages the stakeholders in between, and ends with a judicial blessing of the outcome, though the nuances differ across jurisdictions.

This prepack process can be taken up only when there should be no compromise of rights of any party; and the framework should have adequate checks and balances to prevent any abuse. In this process the creditor is in control, moratorium during resolution and binding nature of an approved resolution plan, which could be considered as part of basic structure of the Code. This soft law is supposed to provide a level playing field and does not disturb the balance of power too much to preserve the credit discipline.

Pre-pack combines the best of the worlds so that insolvency proceedings cause minimal disruption to debtors’ business activities by combining the efficiency, speed, cost, and flexibility of workouts with the binding effect and structure of formal insolvency proceedings. It offers several advantages as compared to the regular resolution process. Here two elements are involved, namely, (a) the informal process, and (b) shorter time for closure. Since the process prior to commencement of formal proceeding is informal, pre-pack provides the stakeholders flexibility in working out a consensual, but efficient, strategy for effective resolution and value maximization that may be difficult under the formal insolvency procedure. It takes less time because a substantial part of the proceedings is undertaken before the commencement of the formal proceeding by the court.

The success of the pre-pack hinges upon the co-operation and active participation of the CD, its promoters, management, and Board of Directors in the process

**Corporate Debtor is the best and often the only person for resolution of stress** – The CD understands the company, its stress, and the possibility of its resolution better. In many cases it could be the only person who is interested in resolution of stress of the CD and can do so. In recognition of this, the pre-pack framework in every other jurisdiction allows only the CD to initiate the process voluntarily and obtain consent of key stakeholders before approaching the Court.

In PPIRP, the management continues with corporate debtor himself, *except in case of fraud*. Thus, disturbance in routine management of enterprise is negligible

In case the PPIRP fails or terminate the jury will Order for liquidation of the company.

1. Explain in detail the essence and result of the restructuring agreement as signed on the 4th of July 2015.

*On 4 July 2015, a Restructuring agreement is finally signed. This is outlined as follows:*

1. *all operating companies of Flow Management Holding BV are to be accommodated in a shell subsidiary, called Flow Management II BV;*
2. *the shares in Flow Management II BV are transferred to the consortium of banks (A, B, C, D) which has financed the original working capital of Flow Management Work BV, as well as to a number of board members (including the CRO);*
3. *Flow Management Holding BV will be liquidated in an undisclosed manner. All claims against this BV will be cancelled by the banks and the shareholder of Flow Management Holding BV;*
4. *Flow Management Holding BV and its shareholder will cancel all claims against Flow Management II BV and its subsidiaries;*
5. *The banks (C and D) which in the past provided Flow Management Work BV with additional working capital will waiver an amount of € 32.5 million. In fact, the entire debt is written off (‘haircut’);*
6. *The consortium that in the past provided Flow Management Work BV with working capital will waiver an amount of € 97.5 million. A € 240 million claim against Flow Management Work BV remains;*
7. *The € 55 million loan in Flow Management Work BV is cancelled in full.*

*The contents of the financial restructuring agreement reflect the relative positions of the financiers involved. The providers of the original working capital possess pledges on most assets of Flow Management Work BV (the main partner in the group) and will receive part of their claim on liquidation. The other financiers (both banks and shareholder) have no or subordinated security rights and will (most probably) receive nothing from their claims on liquidation. As a result of this restructuring, the foundation is laid for selling the company (now being ‘Flow Management II’) in a going concern situation.*

The essence of this agreement is to make “**THE BUSINESS**” of the corporate debtor as a going concern. The stake holders have agreed on the 7 point agenda deliberated in the case study which is reproduced above. The idea is to completely close down the existing company and move all its business to a new company. The subsidiary companies will be part of the new shell company. This will help the company to write off all the claims against it and continue afresh its business in the new company. The Financial creditors namely the Banks A, B, C, and D will become the owners or rather the shareholders of the company. That means the new company will be completely funded and run by the bankers or rather the financial creditors. Further the banks are committed to have the company turnaround and are willing to hire CRO and have the company become profitable. They are willing to fund the entire restructuring process. They are willing to hire the best of best brains on the board and are willing to sponsor their salaries.

Further as informed the Flow Management Holding BV will be liquidated and the present owners will get nothing from the liquidation. They will write off the investment. The bankers A,B,C& D too will write off all their claims. With that Flow Management Holding BV will be totally out of all the claims. Further the Shareholders of Flow Management Holding BV and the company itself will not have any claim on the new company Flow Management II BV.

With regards to the Flow Management Work BV, The Other Consortium who had provided the working capital loan will write off 97.5 million Euros and only 240 million Euros will remain

The funders will get their liquidation value to the extent of the pledge of the assets.

1. Which (potential) legal and/or non-legal cross-border issues – if any – do you recognize in the Flow Management restructuring process?

The structure of the company with various holdings and cross holdings are given in the chart below.



LEGAL CROSS BORDER ISSUES :

As per the restricting agreement, all operating companies of the Flow Management Holding BV will be moved to a shell company called Flow Management II BV. In such a scenario, the following operating companies will get accommodated into the shell company.

* 1. Flow Management Work BV – The Netherlands
	2. FMW Spain
	3. FMW France
	4. FMW Australia
	5. FMW South Africa
	6. FMW USA

First of all, the Flow Management Holding BV is getting liquidated in undisclosed manner

All the claims in the company will be cancelled by both the Banks and the shareholder.

Following three restructuring transactions happening in Flow management Work BV

1. The banks (C and D) which in the past provided Flow Management Work BV with additional working capital will waiver an amount of € 32.5 million. In fact, the entire debt is written off (‘haircut’);
2. The consortium that in the past provided Flow Management Work BV with working capital will waiver an amount of € 97.5 million. A € 240 million claim against Flow Management Work BV remains;
3. The € 55 million loan in Flow Management Work BV is cancelled in full.

Flow Management Holding BV is situated in Netherlands and all the main decisions and management is operating out of Netherlands. Hence Netherland will be treated as the Center of Main Interest (COMI). All the other Jurisdictions like Spain, Australia, France, South Africa and USA will have to follow the Netherlands Jurisdiction. These are the countries which will have to take up interacting with the jurisdiction of Netherlands.

Since Netherland is in the European Region, the laws relating to cross border across the European Union (For countries Like Spain and France) will be less of a challenge in all aspects when compared to dealing with the same aspects in non-European countries. European Union is always pro debtor and they support a Debtor in Control resolution or restructuring. In Europe the proceedings happening in Netherlands might be given recognition.

 In Netherlands a "public" Dutch Scheme proceeding may be opened, which will be publicized by registration in the insolvency register and in which court decisions are public. Dutch "public" proceedings will benefit from automatic recognition throughout the European Union pursuant to the EU Regulation on Insolvency Proceedings. However When the informal restructuring is happening in Netherlands, the recognition of it giving moratorium also may not be a challenging one. Recognition and implementation will be easy.

**AUSTRALIA**

When it comes to Australia, Australia has laws to deal with few countries like Canada, Papua New Guinea, Malaysia, New Zealand, Singapore, Switzerland, the United Kingdom and the United States of America. In relation to other foreign courts, the Australian courts are permitted to exercise discretion as to whether to provide assistance.

Where a foreign proceeding is instituted in a country where the debtor has the center of its main interests, it automatically brings about (in Australia) a stay of proceedings, a stay of execution and suspension of power to deal with the debtor’s assets. In Such circumstances the court may grant any appropriate relief necessary to protect the assets of the debtor or the interests of the creditors

So, in our case of Netherlands, the courts of Australia will exercise discretion as to provide assistance or not. Particularly since it is informal restructure recognition and giving effect to the agreement will not be tough unlike other non-European countries because Australia has agreements with few European Countries which are signatories of the EU Insolvency Regulations.

**SOUTH AFRICA.**

In case of South Africa, foreign proceedings are not easily recognized; particularly the informal restructuring to be recognized will be a challenge.

**UNITED STATES OF AMERICA**

USA has a chapter 15 proceedings to help recognize the foreign proceedings. Hence an application has to be made by the corporate debtor of the foreign company for the recognition in USA. A bankruptcy court will enter an order recognizing the proceeding if the petitioner establishes the existence of a foreign insolvency proceeding and the existence and position of a foreign representative. The debtor in a foreign proceeding is not entitled to any relief, including the automatic stay, until the bankruptcy court actually recognizes the proceeding.

NON LEGAL ISSUES :

I do not foresee much of non legal issues. Johnson family LLS Private Equity Fund, Cinderella Investments Ltd UK have to write off their investments which I do not foresee any legal hurdles

1. In October 2014 four scenarios have been drawn up. Why *was* or *wasn’t* calling for a moratorium (see scenario 4) a good option given the situation at that time? [you are allowed to give your opinion based on your own countries’ Bankruptcy Act; be as detailed as possible]

**Scenario 4**

*A moratorium [formal suspension of payments procedure] or restart following liquidation, with the company being sold in a ‘controlled’ manner. However banks must be willing to provide a bridging loan.*

As discussed in earlier answers and deliberations, the opportunity of Moratorium for the company could have been considered if there was a viability of revival. The Company had come to this crisis stage, where most of the stake holders including the shareholders of the company are hesitant to invest more time and money into the company. The company is in a continuous loss and restructuring has not given the desired results. Losses are mounting and the targets are not getting achieved. Moratorium looks like only extending the death bell of the company by another couple of years and draining down more money of the bankers. Hence the bankers particularly bankers C & D are not interest for any kind of extension of help or facility to the company. One of the good opportunities will be only for a new buyer to take over the company who will buy over the company to expand his business and build the capacity. Furthermore he may want to take the tax benefits of the company. Further if C & D are not allowing the moratorium, the question of fourth scenario does not arise. Any thoughts towards going to support the moratorium will fail and further in Indian context 66% of the creditors/Stakeholders must approve the resolution. Hence even any resolution moved may not succeed and may fail.

A moratorium for sure is going to help a sustainable development. A moratorium will act as a short term relief to meet the pressing needs of the organization. Moratorium may include, among others, alteration of repayment period or repayable amount or the amount of instalments or rate of interest or even the rollover of credit facilities while also giving sanction of additional credit facility or enhancing the existing credit limits and further negotiating the compromise settlements.

In our country India, The Bankruptcy laws are a kind of pro Creditor laws. The creditors have funded the company and the company for various reasons including diversion of funds, improper usage of funds, [misfeasance](https://www.google.com/search?rlz=1C1CHBF_enIN874IN874&sxsrf=AOaemvL_ZC_s9J-LEJfoh7_2bLRZZNvpaA:1636784369829&q=misfeasance&spell=1&sa=X&ved=2ahUKEwibw7_32JT0AhVbwjgGHW7DC34QkeECKAB6BAgBEDE) of funds have caused loss and risked the funds of the bankers (The bankers primarily have funded the company by the deposit of public money) Hence the risk is primarily of the public funds. The laws of India are stringent with the corporate debtor if he gets into the Bankruptcy laws and favour the creditor. When I say favour the creditor, once the application of bankruptcy is admitted, the erstwhile promoters will be discharged from their duties and the Board of directors will be replaced with Board of creditors (who will be primality called as the committee of creditors). This committee will take over the day to day operations of the corporate debtor and consider selling the company to a new buyer who will compensate the creditors appropriately. This stage of the application under Bankruptcy getting admitted till the company is sold off to the new buyer the Bankruptcy law will give moratorium on all the claims, outstanding’s, court cases or anything to do with the outsiders and the company. Once a buyer comes with a plan and if the plan is found to be suitable appropriate and in cognizance with the law of the land an appropriate order is passed by the judiciary. The Buyer in the plan can seek any kind of relief while seeking relief in terms of hair cut to the claimants (Creditors) special reliefs from the government in terms of allowed tax benefits on losses, carry forward of export benefits or export incentives, a good payback period for the creditors and the like.

Further with respect to the bankers coming forward by offering a bridge loan in the present context to the present management might be challenge as you have seen after appointing of a CRO and taking various measures including go slow and no panic with the bankers, the situation has not altered. Rather the losses are mounting and stakeholders are not seeing any ray of hope at the end of the tunnel. Hence the best option at this point of time in the Indian context is to go for Bankruptcy petition and allow any new investor to take over the company through corporate insolvency resolution process (CIRP). In case CIRP fails, we must consider going for liquidation proceedings. In liquidation stakeholders having rights over the security may be in a position to salvage some amount of money.

LEGEND

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