GIPC 2023/2024
CASE STUDY 1
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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?

In my opinion, the cause of the financial distress may be attributed to a combination of external and internal factors.

External environment: Flow Management appears to have been operating in a mature and competitive market, likely with saturated demand and with not much room for growth. This can be seen by (1) the gradual decline in profitability since 2011; (2) the continuing loss in 2014, despite measures taken to reduce costs and turn a profit, including price increases; (3) the write-off of goodwill resulting in the loss of Euro 14.4m in the holding; and (4) the fact that three other parties active in the same industry preferring to buy the company following liquidation – indicative that the real value of the company lie in its business infrastructure and fleet of vehicles, instead of any intrinsic brand equity or goodwill.

Under these conditions, it would have been particularly important for Flow Management to have in place adequate management information system to enable it to detect early warning signals of changes in the market condition, and take responsive measures, such as diversifying into new markets with fewer competitors, and rebuilding its brand equity. Unfortunately, it appears that there were inadequacies with Flow Management's management information system, which resulted in poor decision making on the part of Flow Management, including payment of large bonuses to the holding's CEO and CFO in 2013.

Internal inadequacies: Another key cause of the financial distress is poor management. For instance, the management appeared to have failed to respond appropriately to the changing market condition (such as its failure to review its prices), the company's high cost structure and its inadequate or deficient management information systems. The deficient information had particularly dire consequences between 2012 and 2013. The erroneous accounting entries for the 2012 accounts have led to the company the overestimating its financial position, setting the stage for bad management decisions that has made the problem worse, including payment of large management bonuses in 2012.

In my opinion, the financial distress could have been prevented had the management been provided better information that would have enabled it to detect and respond to changing market conditions. Had management been provided with better and more timely information, it would have been able to detect the early warning signals, and could have taken steps to restructure Flow Management's business, such as recruiting or consulting a turnaround professional (immediate term), improving its cost structure (short term) and adjusting its business strategy (in the mid to long term).

Specifically, management could have taken steps to alleviate financial pressures in the short term like reducing headcount, selling off excessive inventory (which would raise funds and reduce overheads), quicker collection of receivables, and increasing prices. This would have bought management some breathing space to consider steps to restore profitability in the mid to long term, such steps to diversify its business or venturing into new markets with fewer competitors, and cutting down or disposing loss making or non-core businesses.

2. **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?***

Out-of-court restructuring general advantages:

a. **Flexibility:** in terms of what can be implemented, how it could be implement, and the time it takes to be implement.

b. **Confidentiality:** Allows for private, behind closed-door-negotiations, without need to file potentially sensitive and confidential materials into Court. The negative publicity that comes with a court-supervised procedure might make it difficult for the company to undertake business transactions and encourage a race to collect amongst creditors.

c. **Less disruptive to on-going operations:** The debtor company can continue to run the company, without intervention from insolvency practitioners or Courts. This saves costs, especially in relation to larger organisations where fees for insolvency practitioners can run into the multi-million dollar region, and ultimately increases potential recovery for creditors.

Singapore perspective on out-of-court restructuring advantages:

Points (a) and (b) apply equally in the context of Singapore.

(c), however, is mitigated by the availability of debtor-led restructuring under Section 64 of the Insolvency, Restructuring and Dissolution Act ("**IRDA**") which enables a debtor-company to apply for a moratorium while it works out a restructuring plan to present to its creditors, as well as pre-packed Schemes of Arrangements pursuant to Section 71 IRDA (which can greatly reduce time and cost required to obtain a Court-sanctioned scheme of arrangement). These mechanisms have been particularly effective in Singapore because, being a regional trading and financial hub, many companies or creditors will have some form of presence in Singapore, effectively making them bound by any moratorium or other orders issued ordered by the Singapore Court.

Out-of-court restructuring general disadvantages:

a. **Holdouts –** any creditor can potentially object to the restructuring plan and make the plan unattainable.

    a. **Singapore perspective:** In a Court-supervised process, the holdout problem is less significant because voting is based on class, and the Court has power to order cram downs.

b. **Limited option for rescue financing –** lenders may not be as willing to provide rescue financing to distressed debtors, without the priority protection that a court-sanctioned rescue financing could provide.

    a. **Singapore perspective:** Super priority protection afforded by Section 67 IRDA for applications made under Section 64 IRDA (moratorium) and Section 210 Companies Act (Scheme of Arrangements).

c. **Challenging when there is a large number of creditors –** The cost of managing and negotiating with a large numbers of creditors might potentially exceed the cost of a Court-supervised restructuring process. The probability of reaching a unanimous agreement would logically also decrease the more creditors there are.

3. **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.**

   a. **Stakeholder identification and management (Pajunen, 2006):** From early on in the process, the company identified Banks A, B, C and D, as the influential stakeholders, likely because the group was heavily reliant on the banks' financing for its working capital. The company kept the banks informed of the financial situation, its financial projections (notwithstanding that it kept changing) and of its plans to address the financial distress and plans to restore profitability. The company kept open communications and consultations with the banks throughout the process.

   b. **Informal restructuring (Adriaanse & Kuijl, 2006):** The company continued to engage the banks, initially relation to the standstill agreement and which ultimately led to the restructuring agreement signed on 4 July 2015.

d. **Stabilizing (Adriaanse & Kuijl, 2006) / Operational restructuring (Sudarsanam, S, Lai, J., 2001) / Retrenchment (Schmitt, A., Raisch, S., 2013):** The company embarked on cost reduction, revenue generation and operating-asset reduction strategies to improve efficiency and margin in the short term. They included the price increase, reducing head count, and improving loss recovery. nb

e. **Managerial restructuring (Sudarsanam, S, Lai, J., 2001):** To restore confidence in the Flow Management company, the board of the shareholder of the company replaced the CEO and, at the same time, the shareholder deposited Euro 10 million into the company as an unsecured loan with interest, and another Euro 27.5 under the same conditions. The company also agreed to appoint a CRO to assist with the restructuring process.

f. **Asset restructuring (Sudarsanam, S, Lai, J., 2001):** Under the Restructuring Agreement of 4 July 2014, the operating companies of Flow Management Holding BV are divested to a shell subsidiary (Flow Management II), the share of which were then divested to the banks and a number of bboard members. In other words, the assets of value were divested into a new company, free of liabilities. This is to make to set the company up for a viable sale.

g. **Financial restructuring (Adriaanse & Kuijl, 2006):** Under the Restructuring Agreement of 4 July 2014, the various creditors of the company agreed to a combination of debt cancellation, debt reduction or deferment, and debt-equity swap.

One aspect that was not done was "recovery" (Schmitt, A., Raisch, S., 2013), namely making strategic changes that transform and reposition the firm for sustained growth and profitability, such as pivoting to new businesses or into new markets, and rebuilding its brand equity.

4. **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?**

Banks C and D were likely signalling to the other creditors and the company that they could be a potential holdout if their concerns were not addressed. In particular, Banks C and D appeared to have concerns with the management of Flow Management in the light developments since August 2013, the slow pace of the restructuring process, as well as the shareholder's reluctance to commit to inject further capital or raise funds for the company. They could also have been opportunistic by signalling a potential holdout in order to extract a better deal or recovery for themselves.

If I am the advisor of the other two banks, I would: (1) increase engagement and communication with Banks C and D; (2) request the company to increase engagement and communication with Banks C and D; and (3) explore the possibility of buying their out share of the debt at a discount.

5. **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)?**

First principle: The creditors initially agreed not to take legal action pending final report from the consultancy agency, and eventually signed the standstill agreement.

Second principle: the terms of the restructuring agreement reflect the relative positions of the financiers involved.

Third principle: the company did not take any unilateral action that put the creditors at a disadvantage.

Fourth Principle: The 4 banks decided at the outset that action must be taken jointly and in a controlled manner.

Fifth Principle: The company continually kept the creditors informed of its financial position and restructuring plans.

6. **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?**

Other possibilities include:

a) Having a non-binding inter-creditor co-operation protocol that define the rules of engagement, parameters, objectives and any accepted principles to be applied to the restructuring process.

b) Forming creditor committees, comprising representatives of each different creditor class or groups.

c) Creditors can jointly appoint a CRO to the company’s board, with a defined mandate as agreed between the creditors.

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

(a) The operating subsidiaries of Flow Management Holding BV are divested to a newly formed entity, free from liabilities and encumbrances ("**NewCo**");

(b) Creditors of Flow Management Work BV agree to reduce or write off the debt owed by Flow Management Work BV in exchange for equity in NewCo (debt-equity swap);

(c) NewCo to be sold to a buyer as a going-concern;

(d) Creditors of Flow Management Work BV will obtain their recovery either from proceeds of sale of their shares in the New Co, or in the case of the providers of the original working capital, from the enforcement of their security (pledges) on assets of Flow Management Work BV and proceeds of the liquidation of Flow Management Work BV.

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

a) The transfer of shares in each of the Flow Management subsidiaries, from Flow Management Holding BV to Flow Management II BV, are governed by the local company laws. The validity of the share transfers will need to be verified based on the respective local company laws.

b) The transfer of shares may also be subjected to local taxes, such as stamp duty. There may be question as to who is to bear the taxes and how it is to be allocated as between the different creditors.

c) It is not clear what the pledged assets are, or where they are located, but the validity of the pledged assets and the banks' ability to take enforcement measures as against the pledged assets will have to be verified based on the applicable law.

9. **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]**

Calling a moratorium was not a good option at that time.

The company was showing signs of improvement in its results due to the reorganisation. A continuing upward trend may result in the creditors fetching a better recovery from the sale of the company as a going concern, as opposed to a Court-supervised restructuring, or even a managed wind-down process.

This is because once a moratorium is sought (pursuant to Section 64 of IRDA), the process will become public. As a result, the company's clients, suppliers or trading counter parties may approach the company with an increased degree of reserve, as they are not unable to take any enforcement action against the company if needed from any contract that they undertake with the company. This may lead to unwillingness to enter into new contracts (or only be prepared to do so under the stringent of terms, such as cash term only, etc). Ultimately, this may frustrate, rather than assist, the company in its recovery effort.

Further, pursuant to Section 64(4) and (5) IRDA, the company applying for moratorium must provide certain disclosures, including a list of every secured and unsecured creditor of the company, information relating to the company's financial affairs, valuation of each of the company's significant assets, and financial forecasts. The company will have to expend management time and costs, as well as professional fees, to comply with these disclosure obligations, instead of having its resources focused on the on-going recovery process.

Pursuant to Section 64(2) IRDA, by the end of the moratorium period, the company will have to make another application to Court either for an order to summon a creditors meeting to consider and approve a compromise or arrangement to be proposed by the company, or for an order approving a pre-packed compromise or arrangement. This will be time consuming, and will increase expenditure on the part of the company.

These court processes may be disruptive to the company's business operations, and the increased expenses also will mean reduced recovery for the creditors.

Potential buyers might also hold out from any potential acquisition, in the hope of fetching a better price from a distressed sale, rather than a sale as a going concern.

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