1. **What were in your opinion the causes of financial distress at Flow Management? Could the financial distress have been prevented? If yes explain how. If no, why not?**

The causes of financial distress for Flow Management were largely internal and could have been as a result of a rigid top management who were used to conducting business as they always had done and therefore had become unresponsive to changing conditions. Straw *et al. 1981[[1]](#footnote-1)* argues that organisations behave rigidly in threatening situations and seek to maintain the existing status quo.

Research suggests that Long-tenured top management on the other hand attribute failure to external uncontrollable temporary causes. As a consequence, they tend to ignore internal causes of failure and worsen the problem. Success can breed over-confidence and arrogance. Miller (1990). [[2]](#footnote-2)

Research (Katz 1982; Miller and Friesen 1991) further suggests that long-tenured top management are likely to be associated with increased rigidity and committed to standardised practises, a reduction in information processing over time(Kiesler and Sproull 1982; Miller and Friesen 1984; Straw *et al*. 1981), reliance on increasingly narrow and restricted sources of information. The consequence is that long-tenured management tend to spend less time analysing the threats and opportunities facing them (Miller 1993) and become more convinced of the organisation’s ways of doing things (Wanous 1980).[[3]](#footnote-3)

Flow Management had poor accounting principles and didn’t change fast enough to avoid distress. The poor accounting practices were evident in;

* Large management bonuses wrongly issued to the CEO and CFO at Flow Management Holding BV.
* The 2013 loss is caused by the basic principles used in the cost price calculation deviating from reality, because of a formula error in the spread-sheet.
* Lack of periodic checks of the real costs against the results of the cost price calculation resulted in low prices being charged, hence losses.

The financial distress may not have been prevented but it could have been contained sooner if the firm had restructured earlier. The causes of financial difficulties are poor management- inadequate reaction of management to internal weaknesses and strengths- even in the face of external threats and opportunities- and excessive cost structures, as well as the presence of inadequate management information systems within the company (as a result of which important early warning signs of imminent decline are missed by management.

Another cause of the failure could be explained by the voluntaristic perspective that assumes mangers are the principle decision makers of a Firm. (*Hambrick et al.1996; Hambrick and Mason 1984; Szilagyi and Schweiger 1984).[[4]](#footnote-4)* The argument being that failure is linked to internal adequacies in dealing with external threats. The internal inadequacies in this case included;

* Large management bonuses wrongly issued to CEO and CFO at Flow Management Holding BV.
* Book profit not realised in 2012 or 2013.
* 2013 loss is caused by the basic principles used in the cost price calculation deviating from reality, because of a formula error in the spread-sheet.
* Lack of periodic checks of the real costs against the results of the cost price calculation resulted in low prices being charged, hence losses.

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 the disadvantages in your country?**

The general advantages of an out of court restructuring is that it allows the parties flexibility in negotiations. It maybe more economic for smaller firms that may not be able to afford the costs of a restructuring professional. The disadvantages are that without an automatic stay usually provided by the courts, creditors may take a company into liquidation and derail the reorganisation process.

Botswana does not have a developed out of court restructuring. A Scheme of Compromise is the nearest to an out of court reorganisation in the Companies Act.[[5]](#footnote-5) The reorganisation does however require court confirmation to be binding on all creditors.

A compromise in the Companies Act is defined as a compromise between a company and its creditors where a portion or all the debt of a company is cancelled or varying the rights of creditors or terms of debt or altering the company’s constitution in such a way that it affects its likelihood to pay its debt.

A person called “the proponent”, is entitled to propose a compromise including the company’s board of directors, the liquidator of a company or with the leave of the court any creditor or shareholder.

The proponent shall inform each known creditor, the company, any receiver or liquidator a notice of a meeting to vote on the resolution of the proposed compromise.

The court may order that during a specified period from the notice of the proposed compromise up to 10 working days after the date on which notice was given of the result of the voting on the compromise, proceedings with respect to a debt owing by the company are stayed or a creditor refrains from taking measures to enforce payment for a debt owed by the company. Nothing affects the rights of a secured creditor during that period.

A compromise is binding on all creditors or on all creditors of a class if approved. The approval is obtained by duly calling a meeting to vote and is passed if a majority representing 75% in value of the creditors or class of creditors voting in person.

Judicial Management is another restructuring tool used for reorganisation but it must be court sanctioned[[6]](#footnote-6). Any member or creditor of the company can approach the court for an order for judicial management. The order can be in force for a stated period or indefinitely.

The effect of a Judicial Management order is to take control of the running of the affairs of the company from the directors.

The Judicial Manager provides the creditors, company and Master reports every 3 months on the assets and liabilities of the company, its debts and obligations and any such further information he may deem necessary.

Judicial management is cancelled on application to the court if the court is satisfied that the purpose of the judicial management has been fulfilled, or that it is undesirable that the order should remain in force.

**Advantages**

A compromise if accepted by at least 75% of creditors voting in each class is binding on all creditors of that class.

A compromise can be initiated by the company before formal liquidation proceedings. A liquidator can use a compromise during liquidations to restructure the company and possibly return it to trading as a going concern.

Judicial Management gives the company breathing space to orderly restructure.

**Disadvantages**

A compromise does not provide for an automatic stay of further legal proceedings hence creditors dissatisfied with a proposed scheme can take a company into liquidation before the court confirms the scheme of arrangement.

The Proponent of a scheme of compromise is not compelled to draw up a restructuring plan with the input of creditors (although it is wise to do so if the support of creditors is sought). This may affect approval and implementation of the scheme negatively.

Secured creditors’ rights are not affected in this period. Secured assets may make a company attractive to potential buyers or funders. With no guarantees to secured creditors, there may be a resistance to sell secured assets free from encumbrances and thus negatively affecting the restructuring process.

Judicial Management divests control of the running of the company from the directors, who may have the necessary skill to keep the company running. The directors are not compelled to assist the Judicial Manager draw the restructuring plan.

There is no provision for debtor in possession funding, which is much needed to make a restructuring plan successful. Financiers post restructuring are not recognised as creditors and such funding even if it is available is not given priority over other creditors.

**3. Were the turnaround/reorganisation approaches as presented in the reading material applied in this case? If yes, explain in what way. If no, detail what in your opinion should have been done differently.**

Some of the turnaround proposals were applied in the case of Flow Management albeit rather late despite the evidence of distress. Informal reorganisation was the preferred method adopted by the company. An attempt was made to apply the strategies as identified in Adriaanse & Kuijl[[7]](#footnote-7). These strategies included;

*Stabilising.*

The company realised it was making losses. It was not evident what immediate action would be taken to stabilise the situation. It did attempt to increase its cash flow by increasing prices. It also retrenched 350 workers in an effort to reduce operational costs.

*Analysing*

Flow Management did meet with the main financiers and equity holders to draft a reorganisation plan. An accounting firm was called in to investigate the procedures of the company. It was however not clear whether there were short term and long-term objectives. The Company needed to restructure its management, which was only done quite late by the replacement of the CFO and CEO.

*Repositioning.*

The reorganisation plan was commenced late after banks C and D threatened to derail the process in frustration with the slow progress and continued reported losses. The banks were also unhappy with the flow of information from the company, which threatened their support of the reorganisation. Repositioning was therefore a challenge.

*Reinforcing.*

This was implemented late after threats to derail the process from banks C and D.

Measures frequently taken in turnaround situations include cost reduction, debt restructuring, raising new equity, negotiating with banks, improved financial controls and a change of management.

The author argues that appointing turnaround experts and taking important measures to improve the efficiency of a company and improve management information systems are important recovery measures in business restructuring. Financial structuring aims at deferring payments and proposing workout agreements with remission. Improving balance sheet ratios and generating additional liquidity by injecting risk bearing capital.[[8]](#footnote-8)

Other similar measures adopted as reorganisation strategies include managerial and operational restructuring.

*Managerial restructuring.*

The banks were of the opinion that management, in particular the CFO were to be replaced. This is in line with the suggestion from research that Top management change is widely quoted as a precondition to successful turnarounds (Blibeault, 9182; Hofer, 1980). Often banks and creditors will continue financial support only if they are confident the management team can manage the crisis at hand. A change in top management is tangible evidence to bankers, investors and employees that something positive is being done to improve the firm’s performance, even the cause of poor performance may have been beyond management’s control (Slatter, 1984).[[9]](#footnote-9)

In this case the CFO and CEO were replaced only very late in the reorganisation although the banks had expressed their wish to have management replaced earlier on.

*Operational restructuring.*

*Asset divestment*

This was evident in the restructuring of the subsidiaries. There was a sale of surplus assets by the 31st October 2014. Shares of companies outside Belgium, the Netherlands and Luxemburg as well as foreign branches controlled by Flow Management were to be sold off.

Operating companies of Flow Management Holding BV were to be accommodated in a shell subsidiary called Flow Management II BV.

The company focused a lot more on financial restructuring, reworking its capital structure by reducing/eliminating debt and interest payments. This was done by transferring shares of the new company to the consortium of banks and a number of board members including the CRO. Claims against the company were to be cancelled by the banks and shareholder. Entire debt owed to banks C and D were to be cancelled. A portion of working capital lent by a consortium was to written off. A loan of 55 million Euro was to be written off. BV II was to be sold as a going concern. Working capital was made available on the transfer of shares. Additional liquidity generated by working capital was made available on the transfer of shares. In the middle of April 2014, the shareholder deposited 10 million Euro in the company as an unsecured loan.

In conclusion, although measures were carried out to restructure the company, the delayed reorganisation of the top management contributed to the continued financial losses and the lack of trust that developed between the banks and the company.

**4. Banks C and D seem to frustrate the process at a certain point. What could have been (rational and/or opportunistic) reasons 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 might have felt that they might have received more value if the company were liquidated than if they proceeded with restructuring. The banks might have felt there was a lack of frequent and open communication with the company. The constantly changing information from the company did not give the banks assurance that reorganisation would be implemented sooner.

According to the Stakeholders’ influence model[[10]](#footnote-10) frequent and open communication between managers of a company and governing stakeholders enhances the continued support of stakeholders and increases the possibility of an organisation’s survival. They might have been of the view that reorganisation was taking far too long and hence they would have lost their investment if the company’s fortunes were not turned through reorganisation.

Their conduct could have been an indication of their lack of trust in the company. According to the model above, trust reduces the need to monitor another’s behaviour and provides flexibility in decision making and transactions. (Ireland *et al*., 2002).

The continued poor performance of the company might have eroded the banks’ confidence in a reorganisation contributing to the banks uncooperativeness. The stakeholders’ model recommends that management’s association with a company’s good performance enhances the continued support of stakeholders.

As an advisor of the other two banks I’ve have advised them to consider buying banks C and D’s loan to the Company and negotiated the price. I’d have suggested to them that they would be worse off in liquidation as their security was not fool-proof. It would be to their advantage to participate in the restructuring plan as the company’s business was viable.

**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(explicitly or implicitly)?**

The first principle could be found when the company invited its financial creditors to a board meeting as it was experiencing financial difficulties. The company’s banks agreed to discuss the company’s situation. This amounted to implicit cooperation. They agreed that time should be given to the company so information could be gathered about the company’s actual cost and turnover each month. An agreement is reached that the standstill agreement will be signed by 31 March 2014.

The second principle can be found in that as of December 2013 they decided not to take legal action against the company, pending the final report from the consultancy agency.

Principle 5 was observed by allowing an independent accounting firm to investigate the procedures within the company. An independent consultancy agency is hired that concludes the company is viable. A Chief Restructuring Officer is appointed on the insistence of the banks to the company’s board of directors to assist in the restructuring process.

Principle 6 was observed in so far as reflecting the relative positions of the relevant creditors but not necessarily the applicable law. This was contained in the financial restructuring agreement, in that the financiers of the original working capital had pledges on most of the assets of Flow Management Work BV and would receive part of their claim in liquidation.

Principle 7. Information was available that the banks security over the assets of the company were not full proof.

**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?**

Cross class Cramdown of dissenting creditors is an option available and recommended in the UNCITRAL Legislative Guide on Insolvency Law for states to adopt in their insolvency laws. Botswana does not have “soft law” available as an alternative to insolvency laws. Often dissenting creditors can be crammed-down by the court during negotiations in a proposed scheme of arrangement, if 75% in value of the creditors or class of creditors voting in person approve the restructuring plan. In the case where only 50% approve the scheme, an Insolvency practitioner can do very little other than to recommend liquidation.

Another option would be for bank A and B to buy the votes of the dissenting banks C and D as in the case of the South African insolvency law. [[11]](#footnote-11)

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

The transferring of shares in the new subsidiary shell company to the consortium of banks as well as the board members including the CRO was a form of financial restructuring, being an equity-based strategy. The purpose is to raise equity funds via share issues because of pressure from creditors concerned with the security of their lending.

The cancellation of creditors and shareholder claims against of Flow Management Holding BV was to make it more attractive for sale through liquidation by removing all liabilities. It is meant to generate cash flow and profit improvement.

The taking of a “hair-cut” by banks C and D, the waiving of the capital in the amount of 97.5 million Euro by the consortium and the cancellation of the 55 million Euro loan could be described as part of financial restructuring to reduce financial distress, reduce interest costs and improve cash flows. It is a debt-based strategy. (Slatter, 1984)[[12]](#footnote-12).

The result of the agreement is that the providers of the original working capital would receive part of their claim on liquidation.

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

Some of the potential cross-border issues include, recognition of the restructuring process in the subsidiary companies Jurisdictions. The Centre of main interest or COMI is in the Netherlands. The cross-border issue is the recognition of the restructuring process in France, Spain, Australia, South Africa and the USA. Flow Management is part of a group of companies. The re-organisation involves restructuring of group enterprises. The challenge posed would be whether the law of the state each company in the group is situated would recognise the restructuring process in the Netherlands. The UNCITRAL Model Law on Enterprise Group[[13]](#footnote-13) Insolvency is a possible solution to this problem, if adopted by the member states where the subsidiaries of Flow Management are situated.

Another issue would be the recognition of proceedings as insolvency proceedings in the states where the subsidiaries are situated as an initial step to enable the enforcement of the restructuring plan. The restructuring plan of Flow Management was initiated through an informal process and was not court sanctioned. This may be a problem in states that do not recognise informal restructuring proceedings that have not been confirmed by the court as insolvency proceedings.

The recognition of the Group’s creditors in the foreign jurisdiction against the competing interests of the local creditors is another cross-border issue.

**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 the time? [you are allowed to give your opinion based on your own country’s Bankruptcy Act; be as detailed as possible].**

The company was still viable. There was a market demand for its services. A turn around was therefore still possible. The company’s woes were caused by internal factors which might have been ignored for too long. A lack of funding would negatively affect the value of the asset to the detriment of creditors even in liquidation.

1. Adopted from Adriaanse, J.A.A., & Kuijl, J.G. (2006). Resolving Financial Distress: Informal Reorganization in The Netherlands as a Beacon for Policy Makers in the CIS and CEE/SEE Regions? *Review of Central and East European Law,* 31 (2), 135-154. [↑](#footnote-ref-1)
2. *Idem footnote 1.* [↑](#footnote-ref-2)
3. *Idem footnote 1.* [↑](#footnote-ref-3)
4. Mellahi, K., & Wilkinson, A. (2004). Organizational Failure: a critique of recent research and a proposed integrative framework. *International Journal of Management Reviews, 5 (1), 21-41.* [↑](#footnote-ref-4)
5. Ss231-238 Companies Act CAP 41:01 Laws of Botswana. [↑](#footnote-ref-5)
6. Ss470-481 Companies Act. [↑](#footnote-ref-6)
7. (2006). Resolving Financial Distress: Informal Reorganization in The Netherlands as a Beacon for Policy Makers in the CIS and CEE/SEE Regions? *Review of Central and East European Law,* 31 (2), 135-154. [↑](#footnote-ref-7)
8. See footnote 7. [↑](#footnote-ref-8)
9. Sudarsanam and Lai., (2001), “Corporate Financial Distress and Turnaround Strategies: An Empirical Analysis”, *British Journal of Management,* Vol. 12, 183-199. [↑](#footnote-ref-9)
10. Pajunen, K. (2006). Stakeholder Influences in Organizational Survival. *Journal of Management Studies,* 43(6), 1261-1288. [↑](#footnote-ref-10)
11. S. 153 1 (b) ii. Companies Act 71 of 2008. [↑](#footnote-ref-11)
12. See footnote 9. [↑](#footnote-ref-12)
13. Adopted by UNCITRAL on 15 July, 2019 at its 52nd session in Vienna. [↑](#footnote-ref-13)