

# 1 Investments for a Bankruptcy as the Optimization of the 2 Financial Architecture

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## 6 **Abstract**

7 Introduction-The financial crisis tested insolvency frameworks around the world. In Western  
8 Europe corporate insolvency filings rose of 22

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10 *Index terms—*

## 11 **1 Introduction**

12 The financial crisis tested insolvency frameworks around the world. In Western Europe corporate insolvency filings  
13 rose of 22% between 2008 and 2009, with the biggest increases in Ireland (81%) and Spain (77%). Western Europe  
14 is still far from returning to its pre-crisis numbers. At the end of 2011 corporate insolvency filings were still 17%  
15 higher than in 2008. Between 2008 and 2012 Spain recorded one of the biggest increases ? 182%.

16 In 2012 alone the number of corporate insolvency filings in Spain shot up from 5,666 to 7,780. The increase in  
17 corporate insolvency filings in Ireland between 2008 and 2012 was nearly as staggering ? 118%. However, Ireland  
18 has shown some improvement with only negligible increases between 2011 and 2012.

19 Weaknesses of insolvency regimes become apparent during crises. When a weak insolvency framework does not  
20 provide effective formal and out-ofcourt mechanisms to address financial distress, more debts remain unresolved  
21 and more companies become unprofitable, with their assets unavailable to their creditors and little chance  
22 of turnaround. An insolvency framework that allows debtors and creditors to find solutions through fast,  
23 inexpensive, transparent procedures can facilitate debt repayment, encourage lending and lead to a higher survival  
24 rate for viable enterprises.

25 As it was mentioned in a new report by the World Bank Group, the regulatory reform rates remained high  
26 in Europe and Central Asia. 19 countries of the region made all together 65 reforms, aimed at improving the  
27 business regulation standards in the previous year.

28 The report "Doing Business in 2014: Understanding the regulation of activities of the small and medium-sized  
29 enterprises" notes that the efforts of the European and Central Asia countries to strengthen legal institutions, as  
30 well as to simplify the regulation procedures and to reduce the associated financial costs have borne fruit for the  
31 local entrepreneurs. Europe and Central Asia was ahead of East Asia and the Pacific Rim and took the second  
32 place in the world after the member countries of the Organization for Economic Cooperation and Development  
33 (OECD) with highincome by a degree of the most favored regulatory base

34 Author: e-mail: irina@kalinskaya.com for the business environment.

35 Considering this report, 92 % of the European and Central Asia countries have been simplifying the business  
36 registration procedures since 2009. It was the highest rate in comparison with the countries in the other regions  
37 of the world. Nowadays, as a result of these efforts, it is easier to establish a business in the countries of Europe  
38 and Central Asia than in any other region of the world, and is even easier than in the OECD high-income  
39 countries. During the same period, 73% of Europe and Central Asia the countries have made changes to the  
40 process of solving the problems of insolvency responding to challenges arising from the financial crisis, while 85%  
41 have simplified the process of taxation.

42 For example, Ukraine adopted a new insolvency framework that strengthened protections of secured creditors,  
43 introduced debt-equity swaps and streamlined the insolvency process. And Poland, having simplified the process  
44 of business registration and obtaining building permits for the last year, was ranked the 45 th out of 189 in the  
45 world rankings on the favorable business conditions.

46 However, it should be noted that in spite of the half-year effect of innovations introduced in the bankruptcy  
47 regulatory procedures (promulgation of the LU "On Resumption of a Debtor's Solvency or Bankruptcy

48 Declaration") in Ukraine, a position on the criterion of "bankruptcy procedure and resolving insolvency" could  
 49 not be improved due to the persistence of significant time and financial costs associated with the solvency  
 50 recovery procedures or insolvency of business entities, as well as a downward change in the recovery index in  
 51 these procedures. For example, if you have about the same average duration of cases and bankruptcy procedure in  
 52 Ukraine, Poland and Hungary (about 3 years), the average cost of judicial procedures (calculated as a percentage  
 53 of value of the debtor's property) in Ukraine is significantly higher (42% against 15% in Poland and Hungary),  
 54 and the collection rate is much lower than 8,2% (Poland -54,8%, Hungary -38,3%). Some data on resolving  
 55 insolvency are given in Table ??.

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### 58 3 ( )

59 C Table ?? : Resolving Insolvency Rank 1 The average time to close a business. Information is collected on the  
 60 sequence of procedures and on whether any procedures can be carried out simultaneously. Time for creditors to  
 61 recover their credit is recorded in calendar years 2 The average cost of bankruptcy proceedings. The cost of the  
 62 proceedings is recorded as a percentage of the estate's value. 3 Whether business continues operating as a going  
 63 concern or business assets are sold piecemeal (0 as piecemeal sale and 1 as going concern) 4 The recovery rate  
 64 calculates how many cents on the dollar claimants (creditors, tax authorities, and employees) recover from an  
 65 insolvent firm.

66 When analyzing this data we can generalize that despite problems being common to many countries and  
 67 associated with the financial crisis impact the success of implementation of the procedures for resumption of  
 68 solvency of companies or reorganization of really inefficient companies to a large extent is determined by ability  
 69 of the company's management to find a way out of the current critical situation.

70 It should be clearly understood that any problem, faced by the company during its life cycle, is literally a  
 71 matter requiring urgent solutions (in Greek). Thus, if a head of the company, being on the verge of bankruptcy,  
 72 will not be able to reject his thoughts, associated with the fear of losing job/money due to removal from office,  
 73 at such a critical moment then the company's prospects really loom quite unsightly. If the fear dominates over  
 74 the rationality such scenarios can be implemented: Obviously, the above options for an owner of the company  
 75 (or rational manager) are not attractive. From another perspective, a correct way out of insolvency (when the  
 76 court has already accepted a statement of the creditors about initiation of bankruptcy proceedings) shall be  
 77 optimization of the debtor's structural characteristics, which form the basis of his financial architecture and a  
 78 key influence on the possibility of resuming its solvency.

79 The company's financial architecture concept has been proposed for use in the corporate finance sphere by S.  
 80 Myers, an American economist, who identified financial architecture as a changing financial design or financial  
 81 organization of the company, including such structural characteristics as the legal form of the company (public  
 82 or private), ownership structure (concentrated or dispersed), capital structure (the ratio of funding sources)  
 83 and corporate governance system. Different combinations of parameters of the financial architecture determines  
 84 aspects of the operating, financing and investing activities of an entity and actively influence on the financial  
 85 performance formation.

86 Considering that the aim of the debtor's financial architecture optimization is the renewal of its solvency and  
 87 financial standing stabilization, the problems of organizational and financial restructuring of the company are:

88 ? maximization of the potential financial resource level by sources with the minimal cost and minimal  
 89 transaction costs of attraction; ? effective redistribution of property rights and monitoring of the company's  
 90 activities in order to minimize the risks of a hostile takeover; ? optimization of the capital structure for rapid  
 91 reduce in the debt burden; ? protection of the owners' property rights and resolution of a conflict of interests  
 92 between them and other stakeholders (Fig. 1). Investments for a Bankruptcy as the Optimization of the Financial  
 93 Architecture

94 Considering directions of the debtor's financial architecture optimization by its individual components, one  
 95 can undo the following methods of the process. Optimization of the organizational-legal form of the 1. A head  
 96 may agree to attract the required number of borrowed funds to cover debts at such interests that the company  
 97 would be unable to pay in the future. A so-called "effect of mole" appears when the active involvement of  
 98 additional debt leads to "deepening" into a debt pit. 2. First of all, the frightened head will engage unscrupulous  
 99 partners as the investor-partners, who later will impose their vision of business development aimed at gaining  
 100 the maximum short-term returns. 3. The head may unknowingly agree to known illegal schemes to raise funds  
 101 at the attractive interest rates that may eventually cause criminal cases of money laundering. 4. The head-  
 102 fear monger will agree to cooperate with the companies "butterflies", which will provide overvaluation of the  
 103 company's costs for a certain percentage in order to conceal income for the real taxation and payment of taxes  
 104 and other obligatory payments to the budget. Despite the short-term improvement of health and well-being of  
 105 the head, such an operation is often completed with the preparation of a report by a tax inspection and then  
 106 transfer of the inspection report and decision of the tax inspection to the tax police, and then according to the  
 107 Article 212 of the Criminal Code of Ukraine "Tax Evasion", "Bringing to Bankruptcy" etc.

108 company and ownership structure involves the implementation of measures to change the legal status and  
109 structure of the company in the corporate reorganization context, namely: 1) attraction of new members to  
110 replenish the authorized capital to control the statutory limit for a number of members of the company; 2) splitting  
111 the company in order to separate those departments that operate inefficiently. Thus, the problems are clearly  
112 localized and way of their solution will be apparent (modernization, change of personnel, strengthening of security  
113 measures to prevent theft and embezzlement, etc.); 3) the most innovative ways of corporate reorganizations are:  
114 ? modification and / or improvement of the brand / company logo; ? change in the company's registered  
115 address in order to find the region with the most favorable tax climate; ? patenting a new technology that will  
116 change the range of products, modify the company's brand (up to the introduction of new clothes for the new  
117 production), modify the color scheme of corporate colors and present a major new advertising campaign at the  
118 market. The company management can implement the following activities in the process of optimization the  
119 debtor's structure of capital and assets: 1) replacement of the morally obsolete equipment with the new one; 2)  
120 revaluation of all the company's assets not in accordance with the carrying amount and depreciation rate, but  
121 under the commercial prices for the equipment, buildings, etc., which, despite an increase in the tax burden,  
122 will provide cost increase and improve its creditworthiness potential and investment attractiveness in the future;  
123 3) sale of all the unsold inventories of raw materials and uncompetitive finished products, which will provide  
124 additional cash flow and vacation of warehouse premises; 4) installation of the high-tech equipment of a whole  
125 production and / or service department of the company; 5) complete dismantling of obsolete equipment with  
126 termination of the old production of the old product range and full conversion of the company, operating with  
127 the old industrial areas, with a focus on hightech equipment; 6) conduction of an unexpected inventory, selective  
128 and continuous audit that will help you to find unrealized sources for collection of accounts receivable;  
129 7) optimization of the debt capital structure in order to identify those loans that require priority repayment;  
130 8) increase in the share of equity capital through the issue of securities; 9) development and implementation of  
131 an absolutely new investment project with attraction of new investors. Thereby, optimization of the system of  
132 corporate governance and control is designed to ensure the settlement of relations among the company's owners  
133 and managers, as well as decreasing the probability of a conflict of interests between other stakeholders that  
134 under unfavorable circumstances can lead to a deterioration of corporate security of the company.

135 It should be noted that the corporate governance is not only the organization of activities of the Supervisory  
136 Board (the Board of Directors) and system of relationships between the company and its owners to enforce  
137 their rights. Taking into consideration that the investors have increased their attention to the assessment of  
138 the company as an investee, the corporate governance system is an integrated approach to the construction  
139 of foundations and mechanisms for business administration, including strategic planning, risk management,  
140 compliance with the legislative requirements, which would allow it to overcome crises at the macro-and micro-level  
141 with minimal losses. Thus, improving quality of the corporate governance is an important task of organizational  
142 and financial reconstruction of the debtor, which involves the following activities: 1) change of management  
143 and publication of identification data on the top managers, general director, accountants, who unprofessionally  
144 perform their duties at the highest positions in the management bodies, causing financial crisis in the company; 2)  
145 provision of the staff turnover (excluding dismissal of senior officials), which will reveal unscrupulous members of  
146 the staff and will allow to find the staff, who will be ready for the minimum wage to deal with new responsibilities  
147 with a view to the subsequent salary increase; 3) to ensure independence of the internal financial audit by the  
148 members of the Supervisory Council through mandatory acceptance of independent directors with an impeccable  
149 reputation and experience to the Board of Directors and to

## 150 **4 Global Journal of Management and Business Research**

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152 Investments for a Bankruptcy as the Optimization of the Financial Architecture withdraw working shareholders  
153 from the Board of Representatives; 4) to send the company's top managers for retraining, to organize the language  
154 courses at different levels of complexity and for different categories and to organize permanent computer literacy  
155 classes; 5) to engage a life-coach to work with the top management, business and life coaching, as the removal of  
156 personal barriers in life of each of the top managers allow them to take a fresh look at the company's problems; 6)  
157 to hold a number of negotiations with creditors and debtors in the presence of a facilitator company (negotiator,  
158 mediator), who will teach techniques of negotiations, allowing to transform a conflict smoothly into a plane  
159 for the construction of both a debt repayment algorithm and to build long-term cooperation, being mutually  
160 beneficial to both the debtor and creditor; 7) to develop and implement a distance work system (working with  
161 freelancers), what will save money on maintenance and equipment of the work space and provide employment for  
162 certain categories of employees, who are due to certain circumstance in a remote access to the company (women on  
163 maternity leave and / or children of employees, who wish to earn money between classes in the higher educational  
164 institutions (being great on the new technologies), the people close to the retirement age and retired people, who  
165 are well aware of their responsibilities at the company, but which maintenance is economically inefficient for the  
166 company); 8) to establish a regular practice of corporate events (with family members, with departure out of the  
167 city, with the competitions, art contests, etc.) at the company and to equip rooms for catering and joint recreation  
168 at the company; 9) to improve / create standards and norms of corporate culture, starting with the meeting of the  
169 personnel together with the administration of the company for the revision of a collective agreement, particularly

170 in terms of bonuses, cancellation of bonuses and the annual performance appraisal. To establish rules of conduct  
171 and approve them at the General Meeting as a part of the collective agreement. Definitely, implementation of  
172 the above activities will take a lot of human efforts and financial costs, which is especially difficult under the  
173 threat of bankruptcy. However, at the time of financial crisis it is important to focus on implementation of the  
174 rational actions, throwing the panic and fear away. Moreover, it should be noted that any optimization measures  
175 do not give any effect if they are inadequate for an appropriate development stage. Therefore, when determining  
176 specific areas of organizational and financial reconstruction of the debtor company, the company's life cycle and  
177 its financial standing must be taken into account and foremost it is necessary to monitor implementation and  
economic benefits from the use of various optimization measures.<sup>1 2</sup>

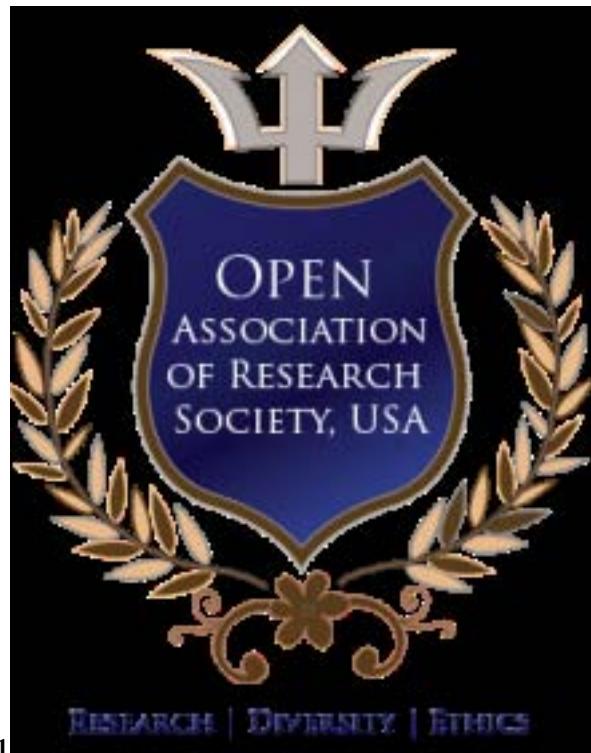


Figure 1: Figure 1 :

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179 [Doing Business 2014: Understanding Regulations for Small and Medium-Size Enterprises ()] *Doing Business*  
180 *2014: Understanding Regulations for Small and Medium-Size Enterprises*, 10.1596/978-0-8213-9984-  
181 2. License: Creative Commons Attribution CCBY3.0. 2013. Washington, DC. World Bank Group (World  
182 Bank)

183 [Myers ()] *Financial Architecture / S. Myers // European Financial Management*, S Myers . 1999. 5 p. .