

*MSMEs or micro, small and medium sized enterprises are the backbone of the Swedish economy (as is with any other nation's economy). As of February 2020, there are 466,500 entrepreneurs in Sweden. There are about 1 239 580 businesses. The Swedish enterprise consists almost entirely of micro and small and medium-sized companies. Companies with 0-49 employees comprise 99.4% of the Swedish enterprise. Medium sized companies with 50-249 employees is 0.5% while big companies with 250 employees and more is only 0.1%. These micro and small businesses are responsible for over 2.17 million jobs.<sup>1</sup> It cannot be stressed enough that these entrepreneurs are one of the important keys to ensuring economic growth, innovation, job creation and social integration.*

*Bankruptcies that were registered for 2019 were 6687.<sup>2</sup>*

*This report aims to look at the policies and strategies aimed at prevention of bankruptcies in the EU and Sweden as well as the promotion of second chance. From this report, our team aims to formulate our own initiatives, strategies and programs through working with fellow entrepreneurs, fellow groups working with the same goal in helping honest bankrupt entrepreneurs. We also aim to work with the government authorities with these initiatives as well as push for changes in policies.*

- EXECUTIVE SUMMARY
- DIFFERENT EU POLICY STUDIES<sup>3</sup>

In May 2002, the European rules on cross-border insolvency were drawn up. The Expert Group<sup>4</sup> recommended the following:

- Introduction of early warning schemes to enable earlier detection of financial distress
- Legal systems with specialised insolvency sections of courts
- A fresh start for nonfraudulent debtors
- Information and education programmes against stigma of failed entrepreneurs

In 2007, The Communication Overcoming the stigma of business failure, COM (2007) asked the Member States to give honest failed entrepreneurs a second chance and showed ways how to overcome the stigma. This was again reiterated by the 2008 Small Business Act for Europe wherein it states, “the Member States should ensure that honest entrepreneurs who have faced bankruptcy should quickly get a second chance”.

The EU, through a group of experts, then followed it up with a showcase of good practices in various countries. This resulted in the invitation of the Competitiveness Council of May 2011 to the Member States to grant honest failed entrepreneurs a debt settlement and discharge time of a maximum of 3 years. A recommendation that Member States should give priority to interventions to support SMEs in the following order:

- Prevention
- Post-bankruptcy and second chance
- Out-of-court settlements
- In-court procedures

<sup>1</sup> <https://www.ekonomifakta.se/Fakta/Foretagande/Naringslivet/Naringslivets-struktur/>  
<https://www.ekonomifakta.se/fakta/foretagande/entreprenorskap/foretagskonkurser/>

<sup>3</sup> FINAL REPORT of The Expert Group 2013 <https://op.europa.eu/en/publication-detail/-/publication/24f281f2-9b0a-44d0-8681-af8bd7657747>

<sup>4</sup> FINAL REPORT of the Expert Group (2003) BEST PROJECT ON RESTRUCTURING, BANKRUPTCY, A FRESH START  
<https://www.iiglobal.org/sites/default/files/EuropeanUnionProjectonRestructuringReportofExperts.pdf>

Further action was done in 2012 by the European Commission, (COM,2012) due to the financial crises that led to about 200,000 bankruptcies. The action reiterated that honest failed entrepreneurs should be given a second chance after a bankruptcy as well as requested for a modernization of the insolvency laws in all Member States, especially with the 3-year discharge and debt settlement period.

In 2013, the Commission again organized a public consultation. The aims of the study which were based on a set of common principles for national insolvency procedures for business in financial difficulties are specifically as follows:

- *The extent to which the Member States comply with the May 2011 Competitive Council recommendations on promoting a second chance and limiting the discharge time and debt settlement for honest entrepreneurs after bankruptcy to a maximum of 3 years by 2013.*
- *An analysis of the procedures for prevention/reorganization as well as for the treatment of the entrepreneur post-bankruptcy and conditions for a second chance in EU countries*
- *The provision of an outline of the work of private credit scoring companies in EU countries, including an overview of the actors involved and their role in bankruptcy and 2nd chance procedures*

The general objectives of which are:

- *To provide an update on introduction by Member states of the 3-year deadline of the European Council on the discharge time and debt settlement for honest entrepreneurs*
- *To give policy makers a measuring mechanism in order to obtain insights on*
  - *How to reduce discharge times*
  - *How to improve the simplicity of procedures*
- *To provide further proposals for legislative and policy actions to foster bankruptcy prevention and 2<sup>nd</sup> chance for honest bankrupt entrepreneurs*

- **FINDINGS** on the 2013 study

- **ENTREPRENEUR-FRIENDLINESS OF THE BANKRUPTCY PROCESS (with respect to:)**

- Court neutrality: courts are neutral in 31 countries; no court neutrality in Italy and Norway which means the court favours either the debtors or creditors

*Sweden: no difference in treatment*

- Length of time of debt repayment plan: Only in 11 out of 33 countries the average time of repayment plan is less than 3 years, in Estonia there is no time limit for debt repayment plan *Sweden: 5 years*
- Repayment plan as part of the bankruptcy procedure: This is the case in all countries except for Belgium, Cyprus, France, Norway and Poland

*Sweden: Has repayment plan*

- Judicial and administrative roles are separated: Separation exists in about 2/3 of the countries.

*Sweden: there is a separation*

- The possibility of creditors' committees (there is coordination among creditors) Creditors' committees do not exist in 5 out of 33 countries.

*Sweden: no committees*

- Tax legislation increasing the recovery rate (cents on the euro) of creditors: This exists in 12 out of 33 countries

*Sweden: exists in Sweden*

- Average time of bankruptcy procedures: The average length of bankruptcy procedure is about 26 months, with outliers for Cyprus, Czech Republic, Turkey and Italy where the procedures can take more than 60 months or 5 years.

*Sweden: 12 months*

- Exemptions of certain assets from bankruptcy proceedings: These exist in 19 out of 33 countries

*Sweden: no exemptions*

- Non-financial consequences of a bankruptcy: These exist in 15 out of 33 countries with the consequence that bankruptcy entrepreneurs with a valid excuse obtain the unfair stigma of being fraudulent.

*Sweden: no financial consequences (more discussion of this in chapter 7)*

## • OUT OF COURT PRE-BANKRUPTCY SETTLEMENTS

Prevention measures which focus on identification of financial problems at a very early stage are less common than the survival procedures. Out-of-court pre-bankruptcy settlements exist in 19 out of 33 countries. It is worth noting that the level of costs of prevention can be problematic as companies in financial distress do not have many resources available. In general, it is difficult for companies in distress to benefit from preventive measures.

## • EASE OF SECOND CHANCE:

- Difference in treatment of honest/fraudulent entrepreneurs: Only 1/3 of the 33 countries treat the groups differently.

*Sweden: no difference*

- Special procedures for SMEs: Only 7 out of 33 countries offer a specific fast-track or less expensive bankruptcy procedures for SMEs.

*Sweden: no special procedures*

- Period to obtain discharge: The average time to obtain discharge after liquidation is 28 months.

*Sweden: 12 months*

- Automatic discharge: This is in place in 1/2 of the 33 European countries.

*Sweden: There is an automatic discharge.*

- Period of negative scoring: On average it takes about 40 months until a negative score is removed after discharge.

*Sweden: 48 months*

- Deleting from a credit database after discharge: In most countries, where a credit database exists, an entrepreneur remains in the credit database for some years to maximally 100 years in 2 countries.

*Sweden: not less than 2 years*



Composite indices have been constructed for each country by scoring the indicators on the 1) entrepreneur-friendliness of the bankruptcy procedures and 2) ease of 2<sup>nd</sup> chance.

- Austria, Latvia and Slovakia scored the highest on entrepreneur-friendliness bankruptcy procedures.
- Romania, Portugal, Slovenia and Croatia have the highest scores for ease of 2<sup>nd</sup> chance.

Qualitative information showed:

- The earlier actions are taken to prevent bankruptcy, the lower the costs involved. Early warning systems and awareness raising as well as financial skills of the entrepreneurs are very important for this aspect.
  - The availability of support measures to facilitate a smooth 2<sup>nd</sup> chance after bankruptcy is limited in many countries.
  - The time for an entrepreneur to be deleted from a credit database (CD), takes longer than the time a negative score remains with a bankrupt entrepreneur. This applies to 12 countries. This has a negative impact on the chance for a successful restart after bankruptcy.
  - The PCSBs Private Credit Scoring Bureaus are well placed to be used as early warning signs since they already cater to this activity for their clients and have the necessary tools to do so efficiently.
- **CONCLUSIONS AND RECOMMENDATIONS** based on the data gathered are as follows: **ON PREVENTION OF BANKRUPTCY:**
    - Entrepreneurs are to be encouraged to act at a very early stage of financial problems. The right environment needs to be created to make this happen.
    - Training on financial planning and management for small entrepreneurs would also improve the situation of early stage financial problems.
    - Establishing automatic early warning systems could be worthwhile to study further like the use of information on delayed tax payments
    - Preventive tax support measures can be considered to help companies overcome temporary financial issues.
    - The creation of an efficient system of exemptions (temporary tax breaks) will enhance the 2<sup>nd</sup> chance for restarting honest entrepreneurs.
    - Entrepreneurship education at secondary school should be advocated to reset the mindset that a bankrupt entrepreneur is a “loser”
    - A uniform/harmonized bankruptcy legislation which can contribute to an equal treatment of honest entrepreneurs across the EU as well as the recognition of out-of-court and hybrid procedures that can avoid regulatory arbitrage or “bankruptcy tourism”

**ON A SMOOTHER SECOND CHANCE:**

- Entrepreneurs should know what the ways forward are after a bankruptcy as well as after discharge. They should also know how a bankruptcy procedure

looks like, what the steps are and the content of each step.

- Eliminate the measures that prevent 2<sup>nd</sup> starters from accessing start-up finance
- Ensure that honest entrepreneurs get rid of negative credit scorings almost immediately after discharge.
- Convince the countries where there is no distinction between honest and fraudulent behaviour of entrepreneurs to change their bankruptcy legislation and introduce a different treatment.
- Make the discharge process as fast as possible to save the resources of the failed entrepreneur for a possible restart

## ON PRIVATE CREDIT SCORING BUREAUS AND CREDIT DATABASES:

Minimal standards and quality oversight are advocated for PCSBs to increase their legitimacy. Such recommendations are given:

- To monitor and/or to limit the length of time that negative information is kept on honest bankrupt entrepreneurs by the PCSBs and CDs
- To have CDs available in all countries in the EU to increase the use of such databases
- To have access to financial information from PCSBs and CDs across the EU
- To reconsider the exemption of micro enterprises for publishing their annual accounts to let micro enterprises provide financial information with less administrative burden (by means of new ICT techniques and software)

### • A MORE IN-DEPTH LOOK ON THE BANKRUPTCY PROCESS

Bankruptcy can be defined as “the legal proceeding that occurs when the liabilities or debts of an enterprise exceed its assets or revenues over an extended period of time” (Caligorou, et al.)<sup>5</sup>

Honest bankrupt entrepreneurs are those who have had failures that are not their fault and have not been fraudulent or irresponsible. (EC 2011)<sup>6</sup>

There are different stages that a financially distressed enterprise goes through (refer to Figure 1 above) as used on the final report (EC 2013)<sup>7</sup> which is used as the main literature for this report.

## SWEDISH BANKRUPTCY PROCESS

In Sweden, a firm is bankrupt when it can no longer pay its liabilities and the inability to pay bills is not temporary, either a member of the board or a creditor can file for bankruptcy. The Swedish bankruptcy code is based on a cash auction procedure is therefore like Chapter 7 of the US bankruptcy code. Once a firm has filed for bankruptcy, a court appointed trustee takes control over the firm and neither the management nor any of the firm’s security holders retain any control rights. The trustee appointed by the court acts in the best interests of the creditors. The firm is then auctioned off as either a going concern or the assets are sold piecemeal. The trustee decides the sale of the assets and

distributes the proceeds to the creditor. The administrative and advisory costs, along with any other costs incurred during the bankruptcy proceedings, receive the highest priority. This is followed by secured claims, certain audit claims, tax claims, wage claims and then unsecured claims. A supervisory body oversees this process. The Swedish government also guarantees the payment of each employee's wages up to the amount of 171 200 SEK for a period of 4 months.

For more comprehensive information on the Swedish bankruptcy process, check [here](#)..

- PREVENTION OF BANKRUPTCY (MORE TO BE DISCUSSED IN CHAPTER 4)

As soon as the enterprise experiences financial problems, the first stage of bankruptcy starts. In this stage, it can still be prevented. The higher chances of surviving depend on the timeliness of the detection and intervention. Entrepreneurs, however, are hesitant to seek for external help for fear of loss of control over their business. (EC,2011)<sup>8</sup>

- EARLY WARNING SYSTEMS

The use of early warning mechanisms is very important in this stage. Although, they will not provide solutions to the problems, they help predict and identify the issues. Some EU Member States employ the following warning systems (Calogirou, et al.)<sup>9</sup>

<sup>5</sup> Calogirou, C., Fragozidis, K., Houdard-Duval, E., Perrin-Boulonne, H. (2010) Business Dynamics: Start-ups, Business Transfers and Bankruptcy, PLANET S.A., CCIP, DTI and GFA, Published in 2011 by the European Commission, DG Enterprise and Industry.

<sup>6</sup> European Commission (2011), Final report of the expert group on "A second chance for entrepreneurs. Prevention of bankruptcy, simplification of bankruptcy procedures and support for a fresh start". Brussels, January 2011.

<sup>7</sup> European Commission (2013), Final report of the expert group on "Bankruptcy and second chances for honest bankrupt entrepreneurs", Rotterdam, October 2014

- European Commission (2011), Final report of the expert group on "A second chance for entrepreneurs. Prevention of bankruptcy, simplification of bankruptcy procedures and support for a fresh start". Brussels, January 2011.

- Calogirou, C., Fragozidis, K., Houdard-Duval, E., Perrin-Boulonne, H. (2010) Business Dynamics: Start-ups, Business Transfers and Bankruptcy, PLANET S.A., CCIP, DTI and GFA, Published in 2011 by the European Commission, DG Enterprise and Industry.

- Internet self-tests/online questionnaires
- Call centres providing answers to entrepreneurs
- Credit scores, financial analysis and stress tests

- PREVENTIVE PROCEDURES

- Informational meetings that entrepreneurs join when they face difficulties
- Training courses that entrepreneurs can join when they face difficulties to learn how to save their businesses
- Support services offered by public agencies to avoid bankruptcy
- Protection from creditors where they give debtors "buying time" to restructure

The report has not stated whether some Member States employ these preventive measures or not. When all fails on this preventive stage, there are 3 options for rescue:

1) out-of-court settlements, 2) hybrid procedures and 3) formal in-court procedures which are discussed here below

- **OUT-OF-COURT SETTLEMENTS**

Restructuring is the next viable solution when it is too late to solve the initial problems. However, restructuring (with external assistance) can be lengthy and costly; something that MSMEs in financial distress cannot afford.

Out-of-court procedures provide the opposite. In this procedure, the debtor and the creditors voluntarily come up with an agreement to recover receivable to allow the survival of the enterprise. There are 2 types of this procedure:

- Contractual workout: debt rescheduling
- Enhanced procedure: in cases where there is a coordination or aggregation problems between the stakeholders, the contract is complemented by a voluntary negotiation, mediation or informal dispute resolution.

Apart from less time and money involved, the other advantage of out-of-court procedure is minimal damage to the entrepreneur's reputation. As the settlement is between the creditors and the debtor, there is less publicity in play. The disadvantage, however, is that a creditor, because it is voluntary, may refuse the adjustments made on the contract. The process in turn will be more costly and lengthy as the out-of-court settlement will have to be eventually settled in court.

- **HYBRID PROCEDURES**

The next option are hybrid procedures; a combination of out of and in-court procedures. Here are some samples of how some countries employ this:

- France: employs 1) ad hoc mandate and 2) conciliation

There is a confidential out-of-court negotiation of the debts but an ad hoc or a mediator is appointed by the president of the court to help the debtor. The report stated that 60% of the cases that underwent this procedure have survived the financial distress.

- Netherlands: the courts appoint "secret curators".

An entrepreneur suffering from financial problems may go to the court and state how he wants to proceed. Without any publicity involved, the court then appoints a curator who will assist the debtor. At this time, the curator is not officially a part of the company but only supervises the process of the sale and prepares the asset transaction. Once the assets agreement (hereby known as "pre-pack") is reached, the official bankruptcy process will commence. The secret curator then becomes the official curator and will supervise the sale and continuation of the company quickly and smoothly.

Banks see this as a positive initiative because secret curators have the time to find the right buyers or investors because they do not have the publicity pressure, nor the time constraints as compared to in-court procedure. In this procedure as well, clients or suppliers do not walk away from the company (i.e. refuse to deliver

goods).

- Other European countries: fast track court approval procedures where the debtor and creditors agree on a debt restructuring plan before the insolvency procedures

There is short term “standstill” where creditors will temporarily not enforce claims while allowing the debtor time to focus on the restructuring plan. When the majority of the creditors approve on the plan, it is sent to the court for review.

The advantage of this hybrid procedure is that there is a court-approved restructuring plan but since there is no formal court procedure, it is quicker than an in-court procedure.

- **FORMAL IN-COURT PROCEDURE**

If the out-of-court procedures nor the hybrid procedures did not work or when the company is already insolvent, formal in-court procedures should be carried out. There are 2 possible outcomes expected from this judicial bankruptcy process:

- Liquidation or company closure
- Restructuring: changes are made to the composition, conditions and/or structure of the assets and liabilities of the debtor.
  - Operational restructuring (also called reorganization or restructuring of the debtor’s business)
  - Financial restructuring (restructuring of the debtor’s finances)

The success of this process is dependent on the rules regulating restructuring plans which in Member States vary significantly. For MSMEs, this process can be expensive as insolvency practitioners and legal advisors charge high fees making the entrepreneurs eventually opt for liquidation; the report stated.

- **SECOND CHANCE**

Second chance means that a failed or bankrupt entrepreneur gets to re-start his entrepreneurial activities. The report has given emphasis to the importance of giving 2<sup>nd</sup> chances to honest bankrupt entrepreneurs as they can use their experiences and lessons learned to let their businesses grow

faster in terms of jobs and turnover. A study (Burchell, B.J. and Hughes, A. (2006),<sup>10</sup> mentioned in the report showed evidence that the attitude towards 2<sup>nd</sup> chance across countries is positively correlated to the GDP growth. This positive attitude may not only even be an advantage for re- starters but also for would-be entrepreneurs who will have less fear of failure from starting a business. In short, giving second chances increases entrepreneurial activities (EC, 2011)<sup>11</sup>.

The EU barometer<sup>12</sup> (43% of the respondents feel) corroborated that would-be entrepreneurs greatest fear is the possibility of going bankrupt. The report also identified 3 consequences that follows a bankruptcy

- Reputation: social stigma is attached directly to the individual. This is true in most countries. More info on this on chapter 7.
- Discharge time: there is a time in most countries where the individual cannot start a new

company.

- Penalties: in some countries, penalties not only apply to fraudulent entrepreneurs but also to honest ones. Penalties may be in the form of bars from public office, access to public procurement or managerial positions

The report also mentioned a few pieces of empirical evidence that show more entrepreneur-friendly bankruptcy laws (such as decreased risks) also attracts entrepreneurs with higher education, have previous experience in the industry and overall higher quality who then form enterprises that perform higher. (Eberhart, et al., 2012)<sup>13</sup>

Thus, a more favourable 2<sup>nd</sup> chance policy increases not just entrepreneurial activity but even better entrepreneurship.

- **EFFECT OF CREDIT DATABASES AND CREDIT SCORING BUREAUS**

As seen on Figure 1, overview of the bankruptcy process, credit databases and credit scoring bureaus affect the prevention stage as well as 2<sup>nd</sup> chances.

Credit scores have 2 opposing effects:

- Effectively warn of upcoming issues giving time for preventive measures or
- Publicise and highlight financial issues taking away the confidence, fast-tracking financial problems and not allowing preventive measures to take place

A clear information on a company's financial health provided by credit scores can help in the financial assessment being able to choose the most efficient solution. On the other hand, an outdated information that remains in the credit database about a previous bankruptcy will be used as part of the credit scoring model. Thus, this affects the entrepreneur's ability to restart.

<sup>10</sup> Burchell, B.J. and Hughes, A. (2006), "The stigma of failure: An international comparison of failure tolerance and second chancing", Centre for Business Research, Working paper 334.

<sup>11</sup> European Commission (2011), Final report of the expert group on "A second chance for entrepreneurs. Prevention of bankruptcy, simplification of bankruptcy procedures and support for a fresh start". Brussels, January 2011.

<sup>12</sup> EUROBAROMETER [https://ec.europa.eu/commfrontoffice/publicopinion/flash/fl\\_354\\_sum\\_en.pdf](https://ec.europa.eu/commfrontoffice/publicopinion/flash/fl_354_sum_en.pdf)

<sup>13</sup> Eberhart et al. (2012), Failure is an Option: Failure Barriers and New Firm Performance. Working paper.

The deletion of outdated credit information therefore plays a great role in the success of the second chance.

- **A MORE IN-DEPTH LOOK ON THE POLICIES AND REGULATORY FRAMEWORK**

- **EU POLICIES ON BANKRUPTCY AND SECOND CHANCE**

In 2000 Council Regulation NO. 1346/2000 on Cross Border Insolvency Proceedings. 25 % of the bankruptcies in the EU have cross border elements. The absence of proper

recognition and coordination of national insolvency proceedings could reinforce bankruptcies to transfer their assets or proceedings to countries where their legal position is most favourable. The regulation deals with these issues as well as overlapping claims coming from different jurisdictions.

In 2007, The Communication COM 2007, invited the Member States to overcome the stigma of business failure in the framework of entrepreneurship promotion under the Growth and Jobs Strategy program.

In 2008, The Small Business Act was drafted and promoted the second chance for honest entrepreneurs.

In 2011, the Competitive Council invited the Member States to promote the second chance for honest entrepreneurs and reduce the discharge time and debt settlement to a maximum of 3 years by 2013.

In 2012, the Commission proposed to make amendments of the 2000 scope regulation to include preventive procedures and personal bankruptcy proceedings. However, this amendment did not cover the differences of procedures in national bankruptcy laws.

In 2013, the European commission adopted a recommendation that aims to give viable enterprises in financial distress access to national insolvency frameworks to allow them to restructure at an early stage and to prevent insolvency. At the same time, it aims to give honest entrepreneurs a 2<sup>nd</sup> chance after bankruptcy regardless of where they are in the European Union. This reduces the obstacles to cross border investments as well as issues with restructuring cross-borders businesses.

- **REGULATIONS ON CREDIT DATABASES AND CREDIT SCORING PROGRAMS**

The legislation and reporting standards of Credit Databases (CDs) falls under each Member State's responsibility. Therefore, they differ depending on the national regulations, approaches and traditions. Data protection, however, is given by the EU through its Data Protection Directive.

With regards to Private Credit Scoring Bureaus, there is no overall EU legislation nor common standards for credit scoring as opposed to credit rating.

The CRR regulation<sup>14</sup>, 2013, harmonised the definitions to only include credit rating agencies, which are registered, authorised and supervised by the ESMA in the EU. In addition, PCSBs could no longer be outsourced by banks as the only assessment risk tools, insisting rather that financial institutions develop their own internal procedures, models and departments.

<sup>14</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013R0575>

- **LEGISLATION ON BANKRUPTCIES**

The bankruptcy and insolvency legislation are under the competence and responsibility of the EU Member States. The legislation on bankruptcy should keep viable companies alive and create an environment in which entrepreneurs dare to take risks and start new companies at the same time protect the interests of the creditors.

Many differences exist across Member States in terms of criteria for opening insolvency proceedings, rules on mandatory filing of insolvency, the capacity of creditors to commence proceedings against debtors, rules on filing and verifying claims for creditors and rules regarding restructuring plans.

As the data on the countries' rankings are from 2013, this summary has included data from DoingBusiness.org<sup>15</sup> for the most recent information on countries' performance on resolving insolvency as well as differences in recovery rate on the dollar. Sweden ranked 17<sup>th</sup> while recovery rate is 78.1 cents on the dollar.

- AN IN-DEPTH LOOK ON PREVENTION OF BANKRUPTCY

In this chapter, specific areas where policy makers play a major role to prevent bankruptcies of financially distressed but viable enterprises.

Refer to this figure

<sup>15</sup> <https://www.doingbusiness.org/en/data/exploretopics/resolving-insolvency#>

**Step A:** Prevention measures: early warning systems

: prevention campaigns to avoid, identify and solve financial weaknesses at an early stage

**Step B:** Survival procedures: agreement with creditors or standardized settlements to let

distressed companies survive

Even if early warning systems and support services are provided, entrepreneurs often do not act promptly because 1) they think they will overcome the problems by themselves 2) overoptimistic of the outcomes (cognitive bias of denial), 3) they fear the consequences 4) not aware of the problem (unknown bias) or the existence of the

preventive measures or 5) a combination of 1-3 reasons.

Costs related to restructuring determines whether restructuring is still an option or if liquidation is the only solution. Lower restructuring costs for MSMEs can lead to better prevention of bankruptcies.

Confidentiality is also another factor. The value or the continuation of the company can be threatened when stakeholders are made aware leading to stigma on the company.

Leniency of preventive measures can also be detrimental. Inefficiencies of lenient systems may only prolong the lifespan of a company that is underperforming. As a result, it can be even more costly.

- **SUPPORT MEASURES TO PREVENT BANKRUPTCIES**

Different measures were identified in all 33 countries.

The report merely provides the list of such measures but no quality evaluation. More so, categories are not better than others as they vary depending on the business situation.

**STEP A:** It is worth noting that no preventive measures have been identified in Sweden. The same goes for Denmark, Finland, Germany with Norway having 1 preventive measure.

Collectively, these prevention measures are:

- Information campaigns
- Websites/online portals with information on prevention
- Early warning (based upon accountants, banks, etc)
- Training
- Automatic warning (based upon check of balance sheets)
- Advisory services

Good practices:

In Belgium, the Brussels Centre des Entreprises en “Difficulté”,<sup>16</sup> organizes field permanencies together with local coordination with municipalities and business centres to reach SMEs themselves rather than waiting for the entrepreneurs to approach them first.

In Spain, the Chamber of Commerce offers the possibility of financial status (and other characteristics) review and then gives a report to companies.

**STEP B:** The measures target to solve the financial problems. In-court procedures are excluded in this step.

<sup>16</sup> <http://ced-com.be/fr/>

Based on advice and voluntary agreements:

- Free or sponsored consulting advice
- Free or sponsored legal and accounting services Based on the rule of Law:
- Out-of-court pre-bankruptcy settlement (including mediation)
- Tax re-payment plans

In Sweden, it is Företagsakuten that offers free or sponsored consulting advice. Business Region Göteborg introduced this regional initiative in 1997. Tillväxtverket is currently supporting this initiative. A few municipal auspices also now have Företagsakuten.

Belgium has employed 3 of these measures.

Good practices:

The Early Warning centre in Denmark<sup>17</sup> is a good example. Everything is done in confidentiality. A consultant assesses a company and then an insolvency lawyer gets in the picture. If the company is deemed to survive, a volunteer from the private sector helps put the company back on track. They are partially funded by COSME, another European Commission initiative.

In Finland, the early warning measures are carried out by the counselling service “Talousapu”<sup>18</sup>. The free services are done online and on the phone. Started out as partially funded by the government but as of 2014, is fully funded by the Finnish government.

In Latvia, it is their tax authority that identifies companies that are late with payments. They then recommend extending the payment time and creating a tax repayment plan. Companies themselves also can initiate and apply at the tax authority.

*In the US:*

Chapter 11<sup>19</sup> of the US law provides temporary protection from creditors and allows time for reconstruction rather than opting for liquidation immediately. Under the same chapter, there is what is called “the lookback period” that provides protection from financial pressure of strong lenders. If a company files for Chapter 11, all preferential transfers that occurred in the last 90 days must be given back to the company. This implies that strong lenders (like banks) cannot demand its money back upon learning of the company’s financial difficulty, even if they are entitled as the preferential lender. The objective is to prevent panic and withdrawals by the creditors that could only lead to the worsened situations and even disadvantaging other creditors. The look back period then protects the company from the creditors’ pressures as well as creditors from the company placing favours on other creditors.

<sup>17</sup> <https://earlywarning.dk/>

<sup>18</sup> <https://www.suomi.fi/services/phoneservice/enterprise-finland-talousapu-counselling-service-centre-for-economic-development-transport-and-the-environment/1e2d4b82-36d7-4fa8-bdd6-4c5b46afc6bb>

<sup>19</sup> <https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics>

- INSTITUTIONS TAKING CARE OF PREVENTION

- PUBLIC

- Government institutions such as ministries of justice, economy, finance or enterprise that take care of the legal and policy background of prevention. Determining the possibility of out-of-court measures or standstill period, order of payment for creditors, legal consequences of delay of payment are some of the things they take care of. The tax authority in Latvia is an example.

Greece has the Government Council of Private Debt Management to monitor the implementation of policies around debt resolution. The Insolvency Service of Ireland<sup>20</sup> also offers different kinds of solutions for debt

- Courts sometimes appoint mediators during the out-of-court settlements. Malta, for example, has the Mediation Centre<sup>21</sup> and Montenegro has the Center of Mediation of Montenegro.

- PRIVATE

- Chambers of Commerce (state or federal level) also offer free consultations or awareness programs as they do in Austria and France
    - Private initiatives such as Talousapu in Finland that is funded by the government.
    - Employers' organizations involved
    - Volunteers as what they have in Early Warning Center, Denmark. They also have regional business development centres that work with them.
    - Sectoral associations like in France or the special centres in Flanders, Belgium
    - Development banks also have their own initiatives. KfW<sup>22</sup>, in Germany finances and administers 2 prevention programs
    - Private business consultants in the legal and financial sector whose services can be hired, often with fees. Insolvency practitioners write recovery plans or Independent legal experts who give feasibility plans. Accountants in the Tribunal de Commerce in France or in Belgium (arranged by law) act as early warning systems.
    - Financial institutions (banks, etc) as major stakeholders, they can also contribute in drafting repayment plans during out-of-court settlements

- COSTS OF PREVENTION AND REORGANIZATION

The level of costs of prevention is very important as these companies are already in financial distress, so they do not have an abundance of resources.

<sup>20</sup> <https://www.isi.gov.ie/>

<sup>21</sup> <https://justice.gov.mt/en/mmc/Pages/The-Malta-Mediation-Centre.aspx> <sup>22</sup>  
<https://www.kfw.de/kfw.de-2.html>

In Sweden, Företagakuten<sup>23</sup> offers up to 5 hours of free consultation. There is not much information as to the comprehensive of their procedure.

In other countries however, the report has compiled a few information. However, there is no exact nor complete set of the costs for many reasons.

- definition of prevention: In a few countries, it could mean consultation while in other countries it can involve a more complex set of procedures
- confidentiality: details such as costs are kept private
- type of cases and degree of severity vary

Here are a few data that came up from different countries

- Denmark: 1500 EUR for a complex advisory process. A lot of the legal and financial assistance come at no cost from various volunteers.
- Germany: 1600 EUR for a Round Table, one of the programs established by the KfW while up to 8000 EUR for a Turn Around Consultancy offering more advanced solutions. KfW offers the financing for the programs mentioned. German companies however reported a total cost of up to 50,000 EUR for smaller companies up to millions for larger companies
- Finland: Free consultation from a lawyer or business consultant through Talousapu. Consultation is between 2-8 days.
- Iceland: 11,000 EUR to reach an agreement between debtor and creditors with the help of external experts. 3,000 EUR of which is funded by the Iceland Innovation Center<sup>24</sup> but mainly for improving processes
- UK: 2000 GBP charged by an insolvency practitioner for submission of an administrative order plus initial advice. Additional advice may cost between 5000 to 10000 GBP. Should a solicitor review the work of the insolvency practitioner, an additional 3000-5000 GBP is incurred
- Croatia: 1000-1300 EUR for a pre-bankruptcy settlement procedure
- Poland: 23000–59000 EUR for a full prevention program (depends on company size) Apart from the reorganization costs, training and advisory support is foreseen as part of the full prevention program
- Czech Republic: 38 EUR/hour where courts can sometimes get involved during out-of-court settlements. Solicitor fees is at least 13 EUR/hour
- Italy: Between 100-1500 working hours is spent by 4 persons for the out-of-court settlement. The country experts were not able to provide the hourly rates so cost estimation is not possible. ex
- Serbia: 1000-1200 EUR for smaller companies and 5500 EUR for larger ones. Companies are also entitled to tax and other incentives (data not available)

<sup>23</sup> <https://www.businessregiongoteborg.se/sv/utveckla-ditt-foretag/ekonomiska-problem-i-foretaget-foretagsakuten-kan-hjalpa-dig>

24 <https://www.nmi.is/en>

- Slovenia: 10000-15000 EUR for their simplified compulsory settlement proceeding. Medium sized companies cost between 30000-40000 EUR

In general, the earlier the problem detection, the easier it can be solved and the lower the costs incurred. As the size of the company or the number of creditors involved increases, so does the costs. Moreover, in some countries where the rescue costs are high, the probability of survival of these financially distressed companies decreases.

- SURVIVAL RATES

The report does not have the exact statistics for the number of companies that benefited from the preventive measures due to the confidential nature of some of the measures. Others, however, that had public support measures have been officially evaluated so some data has been derived.

Företagsakuten in Göteborg has saved 77%, 38 of the businesses that have sought consultation from bankruptcy in 2018.

Here are some data from the other countries:

- Denmark: Early Warning initiative reported on their website<sup>25</sup> that 50% successfully survived while a part underwent reconstruction. They receive about 500 consultations every year
- Finland: Receives 2000 inquiries every year. More than 1/3 of these companies eventually file for bankruptcy.
- Germany: 97% who received assistance from the Turn Around Consultancy from KfW has survived.
- Poland: PARP reported that 100% of the companies survived.
- Hungary: about 1% of the companies in distress seek mediation. Half (50%) of them survive.
- Estonia: reported that they have a 25% survival rate
- Croatia: has between 25-40% survival rate

- POLICY RECOMMENDATIONS

Although there are already many initiatives and services in many countries, even more bankruptcies could be avoided by gearing policies towards mind-sets, awareness and knowledge of entrepreneurs. The following are some of the recommended solutions:

- Encourage Early action and providing the right environment:

Entrepreneurs should be encouraged to act at an early stage. As seen on the table, there are not many countries who provide these. More are focused on ex-post reaction rather than ex-ante prevention

It is important that distressed companies are not penalised by creditors in panic by pushing to retrieve their money.

In addition, that they have readily accessible expert advice at affordable costs.

<sup>25</sup> As of writing, <https://earlywarning.dk/om-early-warning/fakta-om-early-warning>

Denmark, Finland and Belgium are well-functioning examples of these.

Confidentiality should be ensured. In doing so, publicity causing stigma and panic from creditors can be avoided. The Netherlands' secret curator system is a very good example.

The "look back" clause on the US Chapter 11 is a very good example of creating the right environment for prevention.

- Offer training on financial planning and management for entrepreneurs

Trainings that teach entrepreneurs financial management should increase the entrepreneurs' abilities

Topics should be carefully selected as too elementary trainings will not serve any use and will only provide vagueness

A good example is The Business Getaway in UK <sup>26</sup>

- Establish an automatic early warning system

Quantitative models such as those used by PCSB could be used as well as information from tax authorities (such as the case in Latvia)

Confidentiality must be ensured. Entrepreneurs can be informed of the possible issues through email or a phone call. It is then up to the entrepreneur what to do next.

This can be provided by a government body, agency, private companies or volunteers as long as certain minimal standards are applied (regarding model and means of contact)

- Raise awareness on where to get advice and support

This can take on many forms which could be publicly or privately funded.

- Introduce preventive tax support measures

If a company is facing temporary financial issues and tax is proved to be a tipping point, systems to delay tax payments should be available.

- De-stigmatise failure

It should be underlined in entrepreneurship education that there is nothing wrong with failing if you are not fraudulent. This addresses the stigmatisation issue with bankruptcies.

- SEVERITY OF BANKRUPTCY PROCEDURES

An efficient and fair bankruptcy procedure is a very important key in facilitating a second chance for honest entrepreneurs.

- INDICATORS

The experts from the 33 countries have identified 9 indicators on the entrepreneur-

friendliness of the bankruptcy procedures in their respective countries. These are:

<sup>26</sup> <https://www.bgateway.com/>

- Court neutrality
- Length of time of debt repayment plan
- Repayment plan as part of the bankruptcy court procedures
- Separation of judicial and administrative roles
- Creditors' committees
- Tax legislation increasing the recovery rate of creditors
- Average time of bankruptcy procedures
- Exemptions protecting the bankrupt entrepreneur
- Non-financial consequences

It is to be noted that the indicators above belong to in-court procedures, but they do fit into the scope of this study as these procedures have the aim to let viable businesses survive avoiding bankruptcy.

- **Court neutrality:** a court is deemed neutral if they do not favour neither the debtor nor the creditor. The report shows that only in Italy and Norway where there is no court neutrality.
- **Length of time and debt repayment plan:** The Competitiveness Council<sup>27</sup> asked the Member States to allow a maximum period of debt settlement of 3 years by the end of 2013. The results show that only in 11 countries is the average time less than 3 years.
- **Repayment plan, separation of judicial and administrative roles and creditors' committees:** The creation of a repayment plan is not always part of the bankruptcy process as in the case of Belgium, Cyprus, France, Norway and Poland. There is separation of judicial and administrative roles in 2/3 of the countries. The possibility of a creditors' committees signifies that there can be coordination among creditors which further enhances the efficiency of the in-court procedures. The Netherlands has this system in place but is rarely practiced. In theory, 1-3 members of the creditors' committees can advise the insolvency administrator on how to proceed with the enterprise.
- **Tax legislation increasing recovery rate of creditors:** This system exists in 12 out of 33 countries. Spain, for example, has "VAT Recovery". During the 1<sup>st</sup> month of insolvency procedures, the creditors may claim a refund of VAT on unpaid amounts.
- **Average time of bankruptcy procedures:** The average length is 26 months, slightly over 2 years.
- **Exemptions protecting the bankrupt entrepreneur:** Certain exemptions can make would-be entrepreneurs more motivated to start a company as personal consequences related to a bankruptcy can be less severe. However, only in 19 out of 33 countries are certain assets exempted. Examples are:
  - residential house or apartment,
  - certain percentage of the minimum income (welfare assistance),

<sup>27</sup> <https://www.consilium.europa.eu/en/council-eu/configurations/compet/>

- objects considered basic for living (bed, fridge, clothes, basic furniture)
- certain personal belongings
- items required to remain in business (tools of trade, vehicles)

#### *Exemptions in the US*

There are certain assets that are exempted from the bankruptcy procedure such as personal property needed for day to day living. However, these are bypassed by banks when entrepreneurs themselves pledge these assets to increase financing. SMEs are usually dependent on loans during the early stages of their businesses, so a bankrupt entrepreneur usually is left with nothing.

- Non-financial consequences

If the consequences of a bankruptcy are solely financial, then entrepreneurs will have more incentives in starting a business as consequences on a personal level are less. From this study<sup>28</sup>, the experts from 15 countries reported that there are other non-financial consequences.

Examples:

- Interdiction to take a director position in a company for a certain number of years
- Disqualification from positions of public office or a role that requires financial oversight
- Withdrawal of licenses

Although stigma is mentioned in the final report, it is not considered as part of the non-financial consequences. The Expert Group consulted, as is with official regulations, do not consider a wide aspect of non-financial consequence such psychological effects which we believe should be discussed. Personal consequences greatly affect the ability for a re-start for bankrupt entrepreneurs. An in-depth discussion is in Chapter 7.

Here is a comparison between Sweden and 4 other countries for the different indicators.

<sup>28</sup> European Commission (2013), Final report of the expert group on “Bankruptcy and second chances for honest bankrupt entrepreneurs”, Rotterdam, October 2014 <https://op.europa.eu/en/publication-detail/-/publication/24f281f2-9b0a-44d0-8681-af8bd7657747>

For more details, country reports are found here<sup>29</sup>

## 5.2. SEVERITY OF BANKRUPTCY PROCEDURES

A composite index has been constructed to compare and measure the entrepreneur-friendliness of the countries. Scores (1 as highest, 0 lowest) have been assigned to the indicators above to get the total points. Countries with a lower score have bankruptcy systems are severe to businesses.

Austria, Latvia, Slovakia are the most entrepreneur-friendly whilst Poland and Montenegro are the least. See figure below:

<sup>29</sup> <https://op.europa.eu/en/publication-detail/-/publication/b773253b-9a05-449f-8730-5605edb47a56>

- RECOMMENDATIONS

A lot of differences have been observed from the report. For one, fast procedures favouring honest entrepreneurs are not always the case. Even if courts are neutral, bankruptcy proceedings take a long time and a system of exemptions is not always the

case. Therefore, these recommendations are given to give better second chances to bankrupt entrepreneurs:

- Create an efficient system of exemptions.

The exemptions would protect an entrepreneur from losing his/her basic living necessities.

These exemptions should be set clearly and agreed upon in a harmonised way. It should also be ensured that this protection should not be bypassed.

In this way, starting a business is incentivized at the same time addressing the issue of social stigma, affecting less of the personal aspect of the entrepreneur's life.

- Limit the non-financial consequences of bankruptcy

The non-financial consequences mentioned in chapter 5.5 hinders the possibility of second chance. This also gives less incentives to starting a new business.

It is recommended that these consequences should only be applicable to fraudulent entrepreneurs where consequences are deemed appropriate.

- EASE OF SECOND CHANCE AFTER BANKRUPTCY

The second priority intervention area for policy makers as recommended by the 2011 Expert Group is the stage of post-bankruptcy and second chance. Please refer to the figure below.

For the second chance there are 2 possible steps.

**STEP C:** Bankruptcy settlement

**STEP D:** Second chance support, e.g., access to finance or coaching

In many countries, there is no distinction between the treatment of honest and fraudulent bankrupt entrepreneurs even if the latter only comprise 4-6% of the total bankruptcies<sup>30</sup>. The stigma then that is attached to bankruptcy hinders bankrupt entrepreneurs from restarting. It is therefore very important that there is a clear distinction between both for an effective second chance.

Good identifiers of fraudulence are advantageous because:

- Creditors can use these mechanisms as safeguards. Investors can be assured of their honesty and good intentions which gives the honest entrepreneurs possibility of second chance.
- Honest entrepreneurs can also avail of other programmes.

<sup>30</sup> Calogirou, C., Fragozidis, K., Houdard-Duval, E., Perrin-Bouillon, H. (2010) Business Dynamics: Start-ups, Business Transfers and Bankruptcy, PLANET S.A., CCIP, DTI and GFA, Published in 2011 by the European Commission, DG Enterprise and Industry.

- Unfair competition and moral hazards are avoided after bankruptcy. These mechanisms will hinder the fraudulent entrepreneurs to continue their bad behaviour. This limits them as well from benefiting from programs and services that should be for honest restarters.

Faster procedures will also be beneficial. Data shows that the longer the process is, the more company value lost.<sup>31</sup> It also takes the entrepreneur even longer to get back into the market.

Discharge is another factor, specifically the time between liquidation and cancellation of debt. Differences regarding discharge exist in the 33 countries. There are possibilities of automatic discharge, in some countries it is needed to apply for a discharge while in some countries, there is even no possibility of it.

The recommendations from the commission and the IMF that discharge should be automatic should be implemented. IMF calls for a fresh restart for bankrupt entrepreneurs through discharge from the liabilities at the end of bankruptcy procedures as one of the features of an efficient personal insolvency law.

- INDICATORS

There were 7 indicators that the Expert Group have identified to evaluate the ease of second chance in the 33 countries. These are:

- Difference in treatment of honest vs. fraudulent entrepreneurs
- Special procedures for MSMEs
- Possibility to get full discharge
- Period of time to obtain discharge
- Possibility of automatic discharge
- Period of negative scoring is being maintained/documented
- Deleting from a credit database after discharge

The premise is that a faster and more efficient discharge will enable the entrepreneur to start over with a clean slate.

- Difference in treatment of honest vs fraudulent entrepreneurs

The study shows that in most Member States, honest and fraudulent entrepreneurs are treated the same. Only 30% treat them differently. It can be assumed that this adds to the discouraging factors to starting a business again due to stigma.

Consequences, however, may vary. In Lithuania, fraudulent entrepreneurs are prohibited from handling a directorial position within 3-5 years. Within the criminal law, fraudulent entrepreneurs are treated differently. In Austria, dishonest entrepreneurs are not entitled to “Sanierungsplan”<sup>32</sup> or an “Abschöfungsverfahren” or recovery plan.

<sup>31</sup> <https://www.euractiv.com/section/economy-jobs/news/how-many-bankrupt-companies-get-a-second-chance/> <sup>32</sup>  
<https://www.fma.gv.at/banken/sganierungsplanung-nach-basag/>

*In the US:*

If an entrepreneur is found out to be dishonest, he is not eligible for part of the debt to be written off nor will she be eligible for discharge from records and databases. In the most severe case, the entrepreneur will also be criminally liable.

- Special procedures for SMEs

Faster or cheaper procedures for this group is important for their restart. The more time and money spent on the bankruptcy procedures, the less resources are left for a restart.

However, only 7 countries offer this: Croatia, Czech Republic, Luxembourg, Romania, Serbia, Slovenia and Spain.

- Possibility to get full discharge

Honest bankrupt entrepreneurs can obtain full discharge in all the countries except for Serbia where no bankruptcy procedures for entrepreneurs exist. Discharge proceedings is compulsory in 18 countries while it is not in 12. Norway and Latvia make a distinction between natural and legal persons.

Even if there is the discharge procedure, the next question is what is left after it. In Hungary, discharge only comes automatically after the court decision of the debt settlement. In Bulgaria, discharge only comes when all the creditors are satisfied, or the assets of the company are exhausted.

- Period to obtain discharge

The average time to obtain a full discharge after the moment when liquidation is official is 28 months. In some countries like Romania and Spain where discharge is immediate or Hungary, Montenegro and Luxembourg where it takes 3 months or less, the process for honest entrepreneurs after liquidation is fast and efficient.

- Possibility of automatic discharge

In 50% of the countries, discharge is automatic. This means there is no need to re-apply in court. Automatic discharge lessens the administrative burden imposed upon the entrepreneurs during the whole procedure. In Austria, the payment of the quota that is agreed upon in the insolvency proceeding automatically leads to discharge where no additional court decision is needed. It is assumed in countries where discharge is automatic, the re-start for bankrupt entrepreneurs is easier.

- Period of negative scoring is being maintained/documentated

This period means the time until the undergone bankruptcy does not influence the score of an entrepreneur in a private credit scoring database anymore. On average, it takes about 40 months until a negative score is removed after discharge.

- Deleting from a credit database after discharge

In most countries, an entrepreneur remains in a public/private credit database at least one year. This is what holds in 75% of the countries where a database exists. There are no discharge nor databases in Serbia. Italy has abolished public registers while the Netherlands does not allow credit databases. In Bulgaria, Poland, Portugal, Romania and Slovenia, honest entrepreneurs are deleted almost immediately after the debts have been settled.

Here is a comparison between Sweden and 4 other countries for these indicators.

Country reports are found here<sup>33</sup>

- MEASURES FACILITATING SECOND CHANCE

The support measures are divided between the 2 steps, (STEP C) bankruptcy settlement and discharge and (STEP D) second chance advice and support. The report does not show the quality of these measures but only shows it for comparison. See table below

In general, it can be said that tailor-made provisions for second chance starters are not common. In some countries, preparations for such are currently worked on<sup>34</sup>, namely, Sweden, Finland, Bulgaria, Croatia, Poland and Spain. Except for Spain, the specific measures are not yet known. In some countries, second chance provisions are not available at all nor any efforts to change the situation. Refer to the table below:

The Expert Group from Sweden<sup>35</sup> have stated that the question on measures for second chance has political attention as a white paper is in preparation. However, neither the paper nor the title is not available.

<sup>33</sup> Country reports <https://op.europa.eu/en/publication-detail/-/publication/b773253b-9a05-449f-8730-5605edb47a56>

<sup>34</sup> Final Report, 2013 <https://op.europa.eu/en/publication-detail/-/publication/24f281f2-9b0a-44d0-8681-af8bd7657747>

<sup>35</sup> Country reports <https://op.europa.eu/en/publication-detail/-/publication/b773253b-9a05-449f-8730-5605edb47a56>

**STEP C:** This stage highlights the measures after bankruptcy. These measures affect

how smooth and fast the discharge procedures are. These also show the conditions under which a restart can happen. These are the following:

- Recovery proceedings
- Efforts to simplify or shorten discharge
- Honest individual entrepreneurs do not have to face financial consequences
- Possibility to retain items needed for a new business
- Assistance in debt negotiations
- Advice services on discharge procedures

Only in 7 countries do they try to shorten or simplify the discharge. Majority of the countries (22 out of 33) does not have any type of bankruptcy settlement measures. Another measure that entrepreneurs can benefit from is assistance during debt negotiations. In France, MSMEs or agricultural activities can benefit from this kind of help. In Slovenia, honest bankrupt entrepreneurs can ask the court to leave them for assets they need to restart while in Romania, they can immediately start a new one after the court procedure.

**STEP D:** In this step are the measures that assist entrepreneurs who decide to re-open their business. These measures support those who have not given up after initial failure and did not go bankrupt due to fraudulent behaviour. These measures are:

- Equal access to start-up finance
- Assistance with access to finance
- Public support measures
- Guidelines for re-starters
- Awareness raising
- Efforts towards cancellation of a record in a public database
- Individual can start a new company even while during bankruptcy procedures
- Second chance coaching and education

A common measure available in 10 countries is equal access to start-up finance. Germany applies most of the measures with 5 of them available. France and Lithuania apply 3 of the measures.

In Germany, the Federal Ministry of Economics offers guidelines to restarters. They also offer financial assistance to hire an external consultant.

France, as of 2013, cancelled FIBEN 040, an indicator used by banks to pinpoint entrepreneurs' years after their bankruptcy. Initiative France also aids fund creators and those having difficulty. Public organizations directly help with debt negotiations.

In Belgium, there are associations that offer free coaching on how to start a business again. The country also has a mixed financial instrument available.

UK as well as Malta debts are only associated with the company so the individuals can easily start over.

In Luxembourg, the Chamber of Commerce organizes seminars on company administration for those who could reopen their business after bankruptcy after an investigation of the General Prosecution.

In Lithuania, they focus on awareness and presentation of second chance success stories that help spread the perception that an honest bankruptcy as a common event that could happen to any business.

Below is a composite index map for ease of second chance in the 33 countries. 0 is given as the score for the least friendly to second chance and 7 as the friendliest to second chance. It is to be noted that Sweden has a score of 2.5

- INSTITUTIONS TAKING CARE OF SECOND CHANCE

The lack of second measures make it hard to identify what institutions take care of them. We can categorize them as public and private

Public:

Government institutions such as the Ministries of Justice and Ministries of Economy. They closely observe the issue and initiation of any legal changes. In Germany, the Ministry of Economy and Energy provide guidelines where all new starters, regardless of history, can benefit from loans with reduced interest rates from the public business development bank.

Courts: involvement is practical in nature in the sense that they are not involved in policy matters and promotion of 2<sup>nd</sup> chance.

National or federal associations: Assisting entrepreneurs in any stage of the business, they offer consultancy and advice. They are also providers of start-up finance.

Examples are:

National Business Promotion Agency Lithuania<sup>36</sup>: promotes 2<sup>nd</sup> chance and provides new starters with various measures

“Tussenstap” Vlaanderen assisting entrepreneurs during discharge procedures and assisting them with consultancy

<sup>36</sup> <https://www.enterpriselithuania.com/en/about-us/>

Initiative France<sup>37</sup> has mixed financial instruments available

Private initiatives: Costs of consultancies and advice are usually paid by the entrepreneurs themselves.

In Germany, it is possible to public support for such a service and non-profit organizations also organize self-help groups and information events.

In Slovakia, first advice is free of charge.

- COSTS OF SECOND CHANCE

Estimation of costs for 2<sup>nd</sup> chance in the 33 countries is limited as 2<sup>nd</sup> chance measures do not really exist and if they do, there is much variation. Thus, it is difficult to compare. In some cases, 2<sup>nd</sup> chance can mean in-court restructuring which is no longer part of this scope.

Belgium: free coaching for 8 hours.

Germany: 10,000 EUR as estimated by the Federal Association of Insolvent Persons and New Chances estimates the costs of one “second chance case”.

Luxembourg: they understand the costs of 2<sup>nd</sup> chance as the process of authorization of the Ministry of Economy and General Prosecution may start business again. Cost of 5 people involved is 1000 EUR

Slovenia: compulsory settlement involves 5-7 external experts. Hourly rate of financial expert, lawyer, auditor, business valuator and other staff is not mentioned.

- POLICY RECOMMENDATIONS

In most countries, 2<sup>nd</sup> chance measures are not really practiced. Some countries are aware of the issue and foresee legal changes. However, besides Belgium, France or Germany, specific measures are greatly missing. These recommended solutions may give 2<sup>nd</sup> chances to entrepreneurs:

- Create awareness raising campaigns that would help remove the stigma of the honest re-starters and increase their self-esteem.

In the US, the term “bankrupt” was replaced with the word “debtor” in the 1978 Code to help fight the stigma.

- Provide entrepreneurs with clear guidelines explaining the bankruptcy procedures and ways forward after the discharge.

Run contact points that are ready to help entrepreneurs in all stages. This includes specialized advice for discharge and 2<sup>nd</sup> chance.

Improve access to consultancy services such as lower price for discharge proceedings and planning of a new business. Basic information can be provided on a website.

The Belgian system of providing free advice could function as a good example.

- Eliminate all measures preventing 2<sup>nd</sup> chances starters to access start-up finance or public procurement.

37 <http://www.initiative-france.fr/>

In terms of public procurement, this means that if a clause excluding honest bankrupt entrepreneurs exists in the rules, then it should be removed. This should be done at Member State level as most procurement laws and guidelines are set at country level.

A study should be carried out to identify measures and effects that prevent 2<sup>nd</sup> chance starters from accessing finance. From this study, adequate solutions can be recommended.

- Ensure a possibility to get rid of/delete quickly the negative scoring, in the case of honest entrepreneurs. A report on public scoring credit databases should also be annexed to dig more into this.
- Distinguish between honest and fraudulent behaviour when it comes to bankruptcy procedures.

This should include a definition of “fraudulent behaviour” and how countries can make such distinction. For the honest ones, a quicker and simplified procedure could be foreseen.

- Introduce faster and smoother discharge process.

The aim is to allow entrepreneurs to deal with bankruptcy in the shortest possible timeframe and save their resources for a possible new business. As much as possible, discharge should be automatic.

- NON-FINANCIAL CONSEQUENCES

The Final Report did not include certain effects that a bankrupt entrepreneur has suffered as non- financial consequences. What they constituted as such were only withdrawal of certain licences or prohibition from taking certain public positions.

- AFTER FIRM FAILURE STUDY ON SWEDISH BANKRUPT ENTREPRENEURS

A research done by Jenkins<sup>38</sup> showed some effects that we, for the purpose of this report, would like to consider as the non-financial consequences.

Substantial stigma is associated with bankruptcy in Sweden.<sup>39</sup> Historically, bankruptcy was associated with fraudulent entrepreneurs who were punished accordingly. In the 1830s, an insolvent debtor is prohibited to leave the house before the first court ruling and the creditors also had the right to keep the debtor under close surveillance. Despite only 4% is associated with fraudulent behaviour, bankruptcy is still associated with shame and mistrust.<sup>40</sup> The Swedish bankruptcy laws also reflects this history of mistrust.

<sup>41</sup> An example of this is the placement of the firm after

- Jenkins, A. (2012) ,After Firm Failure, Emotions, Learning, Re-entry Jönköping International Business School Dissertation Series
- Ahle, A. 2010. Gåldenärens bibehållna rådighet i ett rekonstruktionsförfarande utom konkurs . Linköping University, Linköping.
- Falkenhall, B., & Wennberg, K. 2010. Företagare i insolvens och misslyckandets stigma, ekonomiskdebatt . Stockholm.
- Sannesson, H. 2011. EU vill ge andra chans efter konkurs, Nya Affärer . Stockholm: Veckans Affärer
- Ahle, A. 2010. Gåldenärens bibehållna rådighet i ett rekonstruktionsförfarande utom konkurs . Linköping University, Linköping.

bankruptcy. The board has no longer control over the firm's assets or the possibility to continue the operations as this is given to the bankruptcy trustee.

The current strict personal insolvency laws in Sweden also has relevance to the stigma associated with bankruptcy as banks are usually the main creditors to SMEs. They can substantially increase the risk using debt to finance a start-up or to expand a firm. The banks often require the entrepreneur to provide a personal guarantee for firm loans.<sup>42</sup> There is no homestead exemption in Sweden and the debt reconstruction process requires an individual to live on bare minimum for 5 years while all income is used to pay the creditors. It is also common for individuals who are in substantial debt to feel shame, isolation, and experience lower health than the regular population<sup>43</sup>.

A Eurobarometer survey asked respondents whether they would order goods from a merchant who had previously failed. Sweden was the country with the highest percentage of respondents who stated that they would not order goods which was at 65%.<sup>44</sup> Second was Italy with 50% while US had 45%.

It can also be taken as it is with the failed enterprise, some entrepreneurs also feel personal failure.<sup>45</sup> They experience grief and loss of self-esteem as they have experienced personal failure in a domain (entrepreneurship) where they have invested self-worth.<sup>46</sup>

Jenkins found out that the appraisal of loss of self-esteem had the strongest influence on grief after bankruptcy. The financial strain also influenced the grief suggesting that the financial and psychological costs of failure are likely to be intertwined. Financial strain is often related to other secondary stressors that can negatively affect an individual's well-being.

The adaptive coping strategies (planful problem solving and seeking social support) act as a mediator between the financial costs of failure and re-entry. The greater use of adaptive coping strategies, the greater the chances for re-entry. The same coping strategies however does not show a strong mediation relationship with psychological costs.

The After Firm Failure dissertation showed that the more the entrepreneur perceived that the cause of failure was about them, and the greater the personal control they perceived that they had over the attribution, the more likely it was that they reflected on their role in contributing to the failure. There were also entrepreneurs who reflected on external factors as the cause of failure.

Entrepreneurs who directed the cause as personal have much lower self-esteem and lesser motivation for the re-entry than the ones who think that external factors were the cause of the failure. The findings suggest that attributions have a direct influence on what is learned, and through this learning also have an indirect influence on the motivation to apply what is learned. This could mean that the learning the failed entrepreneurs have gotten from the bankruptcy can have

- Falkenhall, B., & Wennberg, K. 2010. Företagare i insolvens och misslyckandets stigma, ekonomiskdebatt . Stockholm.
- Kronofogden. 2008. Alla vill göra rätt för sig: Överskuldsettingens orsaker och konsekvenser. Stockholm: Kronofogden
- Jenkins, A. (2012) ,After Firm Failure, Emotions, Learning, Re-entry Jönköping International Business School Dissertation

Series

<sup>45</sup> Sarasvathy, S. D. 2004. The questions we ask and the questions we care about: reformulating some problems in entrepreneurship research. *Journal of Business Venturing*, 19(5): 707-71

- Crocker, J., & Wolfe, C. T. 2001. Contingencies of Self-Worth. *Psychological Review*, 108(3): 593-623.

influences, though not direct, on their second chance. It is encouraged that entrepreneurs should reflect on their actions as this navigation of the experience can facilitate learning.

Jenkins found out that the entrepreneurs who experienced grief after failure were less likely to recover emotionally from the negative experience and they were more likely to rely on escape- avoidance coping which had a maladaptive effect on their emotional recovery. It has been emphasized in entrepreneurship literature that overcoming emotional and financial implications of firm failure is needed to gain the motivation to re-enter self-employment, i.e. entrepreneurship<sup>47</sup> where the emotional and financial recovery relationship is showed.

The indirect relationship that Jenkins found suggests the motivation to enter re-enter self-employment could be viewed as a coping strategy.

Other literature also suggests the role of social context. Failed entrepreneurs also feel a level of social isolation which also influences the reaction and recovery.<sup>48</sup> Job loss study show for example, social network embeddedness helps individuals maintain a positive outlook. Job loss is used as a reference because a loss of a job has similarities to that of the entrepreneur's loss who is after all self-employed.

The findings of Jenkins research show that bankruptcy has a similar impact on well-being to the entrepreneur as job loss to the employee. In many countries, like Sweden, the recently unemployed receives a range of support from the government in terms of financial assistance and re-training to add buffer to impact of the job loss as well as facilitate the re-entry. However, failed entrepreneurs do not receive the same level of support.

- **WHEN BUSINESS GETS PERSONAL: A DUTCH STUDY**

Another more recent study was done in 2017<sup>49</sup> with bankrupt entrepreneurs in The Netherlands. During the interviews, the entrepreneurs reflected on the early days of the venture, the moment of detection of business failure, personal experiences during the failure and the aftermath of bankruptcy and debt rescheduling. The findings reveal multiple interlinked psychological, physical and social effects.<sup>50</sup> Striking severe suffering include heart attacks, alcohol abuse, suicidal tendencies and divorce.

- In the run-up to the bankruptcy, entrepreneurs can lose their motivation and let go of responsibilities (i.e. administrative) and just let things go. This results to sleepless nights which results to emotional instability, tension and unpredictability while still not getting rest and continuously looking for solutions, time and money. As the stress levels increase, the staff also becomes demotivated which hastens the downward spiral.

- Shepherd, D. A., Wiklund, J., & Haynie, J. M. 2009b. Moving forward: Balancing the financial and

- emotional costs of business failure. *Journal of Business Venturing*, 24(2): 134-148.
- Cope, J. 2011. Entrepreneurial learning from failure: An interpretative phenomenological analysis. *Journal of Business Venturing*, 26(6): 604-623.
- Whyley, C. 1998. *Risky Business: The personal and financial costs of small business failure*. Westminster: Policy Studies Institute.

<sup>49</sup> The Story Behind Bankruptcy: When Business Becomes Personal QUT Law Review October 2017, [://lr.law.qut.edu.au/article/view/706/625](http://lr.law.qut.edu.au/article/view/706/625)

When the court imposes the bankruptcy, the entrepreneurs feel humiliation. In this phase, they suffer from emotional exhaustion, psychological and physical problems. Their partners also suffering from the last two problems. A few months after the debt rescheduling (with which they view as too long), they feel a bit of quiet although feelings of frustration, fear, uncertainty of the future and helplessness are present.

- It was indicated that friends and family play an important role in how the bankruptcy and grief are processed. It is to be noted here that the level of stigma placed upon bankruptcy influences this role where the social context is weakened. Family dynamics may be affected as divorce happens causing strain on the relationships between the entrepreneur and the partner/spouse and children.
- The entrepreneurs also feel insecure and anxious about the legal procedure because they often have no idea what their rights and obligations are. The little or no contact from the external resources (lawyers, bankers, accountants) often cause them to fall into an “emotional pit”.
- The entrepreneurs revealed that they have a need to be heard. They further revealed that during the legal process, they feel the lack of emotion which seems to translate as an emotional punishment to these entrepreneurs. Losing a business is compared to losing a loved one where a psychological process like mourning is happening. The lack of empathy, respect and transparency by formal institution representatives is an additional source of grievance. It is therefore, viewed as counter-productive where the legal system itself can impose a stigma on these entrepreneurs.
- The finding that the manner by which the trustee, judge, lawyer, administrator treats an entrepreneur after bankruptcy and during the debt rescheduling theme can have a negative impact implies that there is a connection of the role of emotion in law, particularly empathy.
- As mentioned, trustees may behave in a formalistic, efficient and distrustful way which results to bankrupt entrepreneurs feeling like suspected criminals, thereby exacerbating the problem.

- SUGGESTIONS AND POLICY RECOMMENDATIONS**

This report would like to suggest the following

- that although a failed entrepreneur does not need to fully overcome the psychological costs of the bankruptcy, it is still important for him to have the time to navigate through this negative experience for the purpose of learning
- the more learnings the failed entrepreneur has gotten, the more motivation he will have to restart a business

- once he has started his business, this could be his way of achieving more if not full recovery from the psychological costs
- the more he has recovered from this, the more he will be able to focus on his new venture, the more possibility of success of his second chance.
- If attribution to external factors causes lesser damage on self-esteem and motivation for a re-start, then it is suggested that more efforts should be done in making would-be and existing entrepreneurs the factors in the success of an enterprise. It is emphasized that we are not going to remove personal responsibility from the equation. Only that those who want to run and are running businesses should have more knowledge and comprehension of running an enterprise. Skills on sales, marketing, accounting and many others abound. Managing failure such as the influence of attributions and the roles of coping strategies should be taught as well. This will help the would-be entrepreneur or the failed entrepreneur (through re-training) gain important tools in understanding their entrepreneurial skills and abilities.
- Similar programs (after job loss) should be developed for after firm failure or bankruptcy. The presence of these support will also lessen the fear of running a business, thus more will be encouraged to start one.
- As also suggested based on the Dutch study, trustees and other administrators during the legal process should handle the situation in a better, more effective way. Even the European Commission has recommended specialist judges and specialised training courses for formal representatives adjudicating in or administering the bankruptcy proceedings.
- Awareness programs targeting the society as a whole need to pay attention also to the psychological and social impact of distressed entrepreneurs. This will perhaps also address the employees who got demotivated in the onset of financial failure because perhaps they do not understand what their employer, the entrepreneur is going through.

The level of stigma associated with bankruptcy can influence the extent the entrepreneur reacts negatively to failure and the speed at which they recover. Providing support to manage these non- financial costs is therefore important to second chance for failed entrepreneurs.

## CONCLUSION:

Bankruptcy is essential to the entrepreneurship process. An important factor in the dynamics of an economy that contributes to the positive economic development and renewal. Innovations would probably not be around if there was risk willingness. New and small firms (SMEs) create a a lot of jobs. How bankruptcy can affect the entrepreneur affects the economy in a macro level.

It is therefore very important that a great set of resources from the government and the society is dedicated to preventing bankruptcy, handling bankruptcy, surviving through it and facilitating second chance.