Roadmap

- Why WBG Investment Climate group in the area of insolvency reform?

- Why MSME insolvency? Specific WBG data on MSME that may justify a special treatment in the insolvency terrain

- Specific cases where MSME require a different treatment

- Difficulty of obtaining evidence on impact of insolvency reforms in the MSME terrain
- The biggest development organization, part of World Bank Group, focused on private sector development through investment and advisory services

- As a global investor understands that reliable business exit and solid restructuring frameworks are crucial to a good credit environment

- Since 2009 developing a robust practice focusing on development of insolvency TA around the world, at the request of governments

- Worked in over 20 countries, some of them post-conflict and fragile
Different approaches to a definition of MSMEs

- Different definitions used from country to country usually based on number of assets, total net assets, sales and investment.

Table 1: World Bank definitions of MSMEs (enterprise must meet at least 2 of 3 characteristics)

<table>
<thead>
<tr>
<th>Firm size</th>
<th>Employees</th>
<th>Assets</th>
<th>Annual sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro</td>
<td>&lt;10</td>
<td>&lt;$100,000</td>
<td>&lt;$100,000</td>
</tr>
<tr>
<td>Small</td>
<td>&lt;50</td>
<td>&lt;$3 million</td>
<td>&lt;$3 million</td>
</tr>
<tr>
<td>Medium</td>
<td>&lt;300</td>
<td>&lt;$15 million</td>
<td>&lt;$15 million</td>
</tr>
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Loan size proxies

<table>
<thead>
<tr>
<th>Firm size</th>
<th>Loan size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro</td>
<td>&lt;$10,000</td>
</tr>
<tr>
<td>Small</td>
<td>&lt;$100,000</td>
</tr>
<tr>
<td>Medium</td>
<td>&lt;$1 million (&lt;$2 million for some advanced countries)</td>
</tr>
</tbody>
</table>

Source: Ayyagari, Beck, and Demirgüç-Kunt (2005)

Table 2: Average sales ranges for bank definition of SMEs

<table>
<thead>
<tr>
<th>Firm size</th>
<th>Minimum sales</th>
<th>Maximum sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small</td>
<td>$200,000</td>
<td>$4 million</td>
</tr>
<tr>
<td>Medium</td>
<td>$2 million</td>
<td>$16 million</td>
</tr>
</tbody>
</table>

Source: Beck, Demirgüç-Kunt, and Martinez Peria (2008)
Why should there be tailored insolvency regimes for MSMEs? SMEs are the backbone of growth and entrepreneurship.

- SMEs provide a significant portion of formal jobs worldwide:

![Graph showing SME contribution to formal country employment](image)

**Figure 4:** SMEs provide a significant portion of jobs worldwide

SME contribution to formal country employment (median values)

- Low-income: 20%
- Middle-income: 60%
- High-income: 80%

*Source: Ayyagari, Beck, and Demirgüç-Kunt (2003)*
Why should there be tailored insolvency regimes for MSMEs? Finance is often a severe constraint.
Why should there be tailored insolvency regimes for MSMEs? Time and cost effectiveness

♦ Insolvency typically leads to lengthy and complex legal proceedings

♦ This is in itself counter productive as, the more time goes by, the more value is destroyed by the debtor.

→ While larger companies are usually better suited to cope with this inherent cash flow issue, MSMEs need alternative insolvency regimes that are:
  - Shorter
  - Less cumbersome
  - More cost-efficient
OHADA: concern that West Africa needed to ease business exit, and if possible, rescue for its many micro businesses

- OHADA is an organization of 17 West and Central African countries whose purpose is to harmonize business law.
- Uniform Acts adopted at the OHADA level become immediately applicable in every OHADA country.
- IFC/World Bank assisted in modernizing the Uniform Act on insolvency (pending finalization)
Tailored MSME Insolvency Regime in draft OHADA Law 2013

♦ Simplified Procedures for Reorganization and Liquidation for MSMEs pre insolvency:

*Règlement Préventif Simplifié*
- Qualifying threshold is 5 or less employees within the six months preceding court referral
  - Easier evidentiary requirements to open proceedings
  - No appeal against settlement
  - Duration of proceedings reduced from 3 months (+1 month extension) to 2 months (+15 days extension)
  - Option for the judge to appoint an independent expert to ensure execution of the settlement agreement (concordat).
After MSME debtor is insolvent:

- **Redressement Judiciaire Simplifié**: Simplified reorganization proceeding for SMEs with 5 employees or less (in the six months preceding court proceedings) AND with an annual turnover not exceeding USD 100,000.
  - Period to prepare reorganization plan shortened from 9 months to 4 months (+ 15 days)
  - Court may impose rescheduling up to 2 years on creditors (with their consent)

- **Liquidation des Biens Simplifiées**: Simplified liquidation proceeding for SMEs with 1 employee or no employees (in the six months preceding court proceedings), and no real estate.
  - Expedited proceeding: contractual sale of assets instead of public auction process
  - Only claims that are likely to be paid are checked for admissibility
  - Liquidation process may not exceed 9 months
Summary of changes in MSME framework compared to “general” framework

♦ Broadly, the differences for MSMEs are that:

- Time-frames are shorter;
- Evidentiary requirements are lighter;
- Fewer procedural steps;
- There are fewer or no appeals permitted; and
- The court has the discretion to refuse to apply the simplified procedure and can use the “general” framework if it so chooses.
India: the problem of outdated personal bankruptcy legislation

♦ According to the 2001-2002 census of Small Scale Industries (SSI), proprietorships or partnerships constitute 97.3% of all units in India, leaving a tiny minority of business units, and a very tiny proportion of small units, that are incorporated.

♦ India follows a Common Law model where unincorporated businesses are subject to personal bankruptcy laws.

♦ India’s personal bankruptcy laws are outdated: The Provincial Insolvency Act 1920 and The Presidency Towns Insolvency Act 1909. For instance:
  - Severe criminal penalties including imprisonment
  - Benchmark amounts such as 500 Rs (about $10) for the minimum amount of debtor’s debts, etc.
Some States are updating their personal bankruptcy laws at a state (rather than federal) level. Need to consider:
- Simple arrangements to avoid bankruptcy
- Fresh Start Concept;
- Removing criminal penalties and reducing stigma; and
- Easier procedural requirements.

RBI has promoted a Debt Restructuring Scheme for viable SMEs:
- This mechanism is applicable to all borrower who have funded and non-funded outstanding up to Rs. 10 crores under multiple/consortium banking arrangement.
- Restructuring package is worked out and implemented within 90 days from the date of receipt of request for restructuring from the borrower.
Final question: How will we know if MSME new insolvency system works? – Impact measurement challenges

- How to measure the success of an insolvency reform?
- How to quantify such success?
- How to attribute success specifically to the insolvency reform and not to, for example, market factors
- Would “baseline surveys” (capturing data pre and post reform) be an adequate tool? If yes, what content
- Should data be captured on specific cases or globally?
- Other questions...
Thank you

Questions?

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