



COMPANY REORGANIZATION THROUGH PRE-PACK REORGANIZATION PLAN

REORGANIZACIJA KOMPANIJE NA OSNOVU UNAPRED PRIPREMLJENOG PLANA REORGANIZACIJE

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Abstract:

The aim of this paper is to highlight the pre-pack reorganization plan (PRP or UPPR in Serbian), as an alternative method in resolving the financial difficulties of the debtor, and present its advantages and disadvantages in the implementation, as well as the economic aspects that lead to the downfall of the company. UPPR is a hybrid procedure, which involves the inclusion of the court, but to a lesser extent than the traditional process. This model is more than the restructuring of debt and capital structure. The application of this unique approach implies the fundamental change of the company's operations as well as its business policy, which eliminates the accumulated debts and negative trends. Pre-pack reorganization plan (UPPR) is a plan that the debtor prepared in cooperation with creditors and submitted simultaneously with a proposal to initiate bankruptcy proceedings. Unlike other solutions, pre-pack reorganization plan may be voted in advance, when the Law of Bankruptcy allows for such an option. This model represents the solution for overcoming the critical situations and avoiding bankruptcy or liquidation procedure.

Key words:

reorganization plan, bankruptcy, debtor, creditor.

1. INTRODUCTION

The issue that concerns most the leading economists in the country is the fact that almost one third of the Serbian economy is not able to properly back their loans. According to the Association of Serbian Banks, there is a growing number of loan repayment problems. Venture investments have become a heavy burden to banks, because there is actually the trapped capital problem. When the company is no longer able to regularly service their obligations, it needs to access some of the restructuring and reorganization models.

Restructuring is a process in which the company needs to make changes in all areas of its business and adapt to new market conditions and challenges offered by the environment. One of the models for resolving the financial difficulties of the debtor is Pre-pack Reorganization Plan, which should represent more than just debt restructuring and capital structure. This model should enable the company to make changes in all operations with special emphasis on changes in management. It is difficult to understand that the current management will bring back the company on its own legs if they contributed to the existing situation, which resulted in the reorganization plan.

Apstrakt:

Cilj ovog rada jeste da istakne unapred pripremljen plan reorganizacije (UPPR) kao alternativnu metodu za razrešavanje finansijskih poteškoća dužnika, kao i da ukaže na njegove prednosti i nedostatke, kao i na ekonomske aspekte koji vode do propasti kompanije. UPPR je hibridni proces, koji podrazumeva učešće suda, ali u manjoj meri u odnosu na tradicionalan pristup. Ovaj model je više od rekonstrukcije dugovanja i kapitala. Primena ovog pristupa uslovljava promenu poslovanja preduzeća iz temelja kao i njegove politike, čime se eliminišu nagomilana dugovanja i negativni trendovi. Unapred pripremljen plan reorganizacije (UPPR) je plan koji dužnik priprema u saradnji sa poveriocima i dostavlja zajedno da predlogom za pokretanje stečajnog postupka. Za razliku od ostalih rešenja, unapred pripremljen plan reorganizacije može biti unapred izglasan, ukoliko zakon o stečaju dozvoljava takvu mogućnost. Ovaj model nudi rešenje za prevazilaženje kritičnih situacija i izbegavanje stečaja ili likvidacije.

Ključne reči:

plan reorganizacije, stečaj, dužnik, poverilac.

2. REORGANIZATION AND RESTRUCTURING AS A MODEL OF RECOVERY

2.1. ANALYSIS OF THE ECONOMIC ASPECTS AS THE CAUSE OF THE COLLAPSE OF THE COMPANY

Previous studies indicate the growing number of failed businesses in the countries in transition, resulting in unprofitable business, accumulation of debt and problems with cash flow. Based on the empirical research, conclusion could be made that the main causes of failure are classified according to the place of their origin internally and externally (Kontić, 2007).

The most common internal factor of crisis within a company is inadequate management, which causes failure in 70% to 84% of cases. When a company does not achieve the desired results, the leaders at the top of the pyramid management carry the responsibility for such actions (Kontić, 2007). According to the survey results (Khandwalla, 2001), the lack of professionalism is causing the crisis in 21% of the companies. Significant external causes affect competition and open markets, where the



state does not appear as a protector of domestic products. Furthermore, changes in market demand can be important, as well as the inability of the companies to adapt to the changes in the market and identify future developments.

	Slatter (1984)	Gething (1997)	Khandwalla (2001)
Internal causes			
Inadequate management	73%	84%	70%
Inadequate financial controls	75%	60%	
Inadequate cost structure	35%	56%	
Weak marketing	22%	20%	17%
Large projects	17%	20%	21%
Acquisitions	15%	72%	
Financial Policy	20%	84%	
External causes			
Changes in market demand	33%	68%	47%
Competition	40%	44%	42%
The pricing policy	30%	20%	
State policy			29%
Strikes			23%
Adverse circumstantial			22%

Table 1- Research factors

Research results (Bibeault, 1982) showed that 40% of the companies undergoing the crisis have centralized management, which moves the managers away from the source of difficulties and thus cannot effectively manage it. Management mistake is also an inadequate response to changes (outdated products, technologically obsolete factories become inefficient, *etc.*). These factors (Khandwalla, 2001) lead to a crisis in 37% of the companies.

Financial factors represent a problem the enterprises often encounter. A major issue for the company is the inability to find a new capital in the market and growing indebtedness, which continues to lead the company into losses and the inability of gaining cash. Impossibility or bad collection of receivables policy appears to be the cause of failure. These factors mostly affect small businesses, which find it difficult to cope with the new situation, mostly due to the small market share. Large companies, financed by the state, become privileged and get the necessary time for overcoming the crisis. These are the companies with production program, predominantly exporters, large taxpayers, as well as the companies that dispose of a large number of employees.

Marketing orientation is one of the success factors *i.e.*, factors of failure of the company. Marketing gains importance during the crisis, when the costs in these positions first reduced.

When a company enters into a process of reorganization, it entails a poor marketing and distrust of creditors.

An important external causes of the company crisis are re-duction and changes in demand for products or services. Empirical research (Khandwalla, 2001) showed that the decrease in demand caused the crisis in 47% of the companies and is the most common external factor.

2.2. MODELS OF RESOLVING THE DEBTOR-CREDITOR RELATIONS IN SERBIA

As regards the issue of liquidity, i. e. inability of the company to meet its financial obligations caused by accumulated debts, it is recommended to immediately approach to redefinition of debtor-creditor relationship. This can be accomplished through assuming formal or informal approach. The informal approach involves the restructuring of liabilities to key creditors, which are realized outside the court. A formal approach involves redefining the debtor-creditor relationship by going to court, the bankruptcy or reorganization plan by defining the company. In practice, alternative methods are used that involve a combination of formal and informal approaches. The so-called hybrid procedure involves the inclusion of the court, but to a smaller extent compared to the traditional process. Following the introduction of the Bankruptcy Law of 2005, the hybrid model procedure emerged in Serbia, as an option to the plan of reorganization filed simultaneously with the suggestion for the initiation of bankruptcy proceedings.

2.3. PRE-PACK REORGANIZATION PLAN

Pre-pack reorganization plan (UPPR in Serbian) is a model in which the borrower prepares a plan in collaboration with stakeholders and submits it simultaneously with a proposal to initiate the bankruptcy proceedings. Unlike other solutions, pre-pack plan of reorganization may be voted in advance, when the Bankruptcy Law allows for such an option. Ballot papers of creditors with certified signatures of authorized persons shall be submitted along with the plan. In addition to the signed statements of the majority of creditors that they are agreed with the contents of the plan and voted for adoption, it is stated that such a statement is considered a ballot (Radulović, 2013). Essentially, pre-pack plan of reorganization represents a call to negotiate a reorganization plan with creditors and asking for acceptance of the plan prior to filing the application for bankruptcy, bearing in mind that the creditors can rapidly reach an agreement, a bankruptcy can rapidly come out (Čolović, 2013). The specificity of the UPPR process is reflected in the necessity of conducting negotiations with all creditors in order to gain confidence and their decision to accept the proposed plans, through official statements. The main components in the selection of this model are creditor's agreement, avoiding complete ceasing his activity and the preservation of the business.

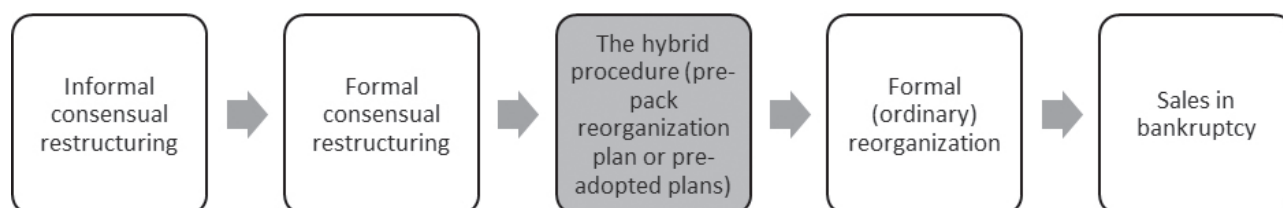


Figure 1: Models of resolving the financial difficulties of the debtor

Source: Garrido, J. M. (2012)



UPPR enables the company to continue operating through debt rescheduling and implementation plan. Unlike other recovery strategies (consensual financial restructuring or traditional reorganization), there are more possibilities for the positive turnaround in the business, *i.e.* the company is directed towards the recovery, not towards closing down.

This restructuring model represents a modern economic solution, which offers numerous possibilities to overcome the crisis, and preserve the company. However, it leaves space for consideration, due to the fact that the new opportunity is being given to the illiquid companies. The result of this method of recovery can be successful reorganization or damage interests of creditors and liquidation of the company.

Pre-pack plan of reorganization as an independent institute is defined and regulated for the first time with the provisions of the Bankruptcy Law (2009) modeled on Chapter 11 of the Bankruptcy Law of the United States. The provisions of the Bankruptcy Law, in terms of normative development of UPPR, are complemented by the relevant bylaw Rulebook on the manner of implementation of the reorganization plan and its contents (Regulations on the implementation of the reorganization pre-packaged plan of reorganization and the contents of the plan, 2010). Amendments to the Bankruptcy Law of 2014, primarily aimed at preventing the acts of corruption in the course of the bankruptcy proceedings, increase transparency, reduce costs and increase efficiency of the bankruptcy proceedings, with further refinement of individual institutes for higher legal certainty.

The most important changes in the Law of 2014 relate to the following:

- ◆ Fourth payment priority rank includes claims resulting two years before the date of initiating bankruptcy proceedings on loans (or other legal actions in economic terms are the same as loans) approved by the related parties – *i.e.*, no receivables from sales of goods and services...
- ◆ Reorganization Plan is submitted to the Commission for Protection of Competition and the authorities responsible for state aid for small and medium-sized enterprises...
- ◆ If it has passed nine months from the date of the section, it is necessary to update it by another independent auditor. The plan should be submitted within 90 days.
- ◆ The hearings cannot take place in a period less than 20 days from receipt of the decision of the Commission for Protection of Competition
- ◆ Related parties in UPPR belong to a special class that does not vote on the plan, and in PR are in classes of bankruptcy creditors depending on the payment priority

The advantages of UPPR's are (Nikolić, 2011):

1. Speed - the relatively quick way to solve the problem of debtor-creditor relations.
2. Saving - Relatively lower costs compared to "normal" reorganization in bankruptcy:
 - the absence of formal insolvency and regular continuing operations,
 - not so favorable for small-sized debtors and those not requiring audit,
 - Inexpensive compared to ordinary reorganization - for medium-sized and large companies.
3. The absence of bankruptcy trustee:
 - keep management and employees, reduced the effect of stigmatization.

4. Minimize negative effects on business:
 - normal continuation of cooperation with suppliers and customers,
 - ability to prevent blockages account.
5. Shorter period from launch to adoption - legally limited duration - between 30-45 days, with an extension of up to 65 days.
6. A higher degree of creditor collection.
7. Reduction of holdout problem (the problem by blocking minority of dissenting creditors), - in case of the relatively small number of dissenting creditors (*e.g.* less than 5%), the borrower cannot pay them in full and continue the process of negotiating, otherwise there is a blockade.

Two reasons for holdout are as follows:

- ◆ The problem of coordination among the creditors of the same class (class dispersed implies a higher chance of failure due to lack of coordination).
- ◆ The problem of transfer values between different classes (the reorganization plan allocates values in a way that is favorable for a class in relation to another).

This model of bankruptcy is only for large system companies who have great influence and a wide net on the market, because only they can convince creditors that the better solution is to wait for the consolidation, than attempt to take charge of the estate, which may not be sufficient for the debt payment.

3. ANALYSIS AND EVALUATION

In a situation when the company operates with a loss, only a radical change of direction can lead to business profitability and productivity.

The key to recovery is in a rigorous assessment of the business situation, the consistent implementation of the stabilization process, in our case UPPR, the establishment of control and supervision in order to overcome the current situation and create a healthy system that will generate revenue in the long run.

According to (Slatter, 1984), the proposed strategies for successful recovery are as follows:

- ◆ Change in management, which involves a situation when the company needs a new CEO. In such a situation, setting up of the new management, establishes new positive recovery strategies that are presented to bankers, investors and employees in the company.
- ◆ The strict financial control, which basically includes the cash flow and budget forecast, as well as detailed knowledge of production and general terms of costs, as well as control over capital expenditure. It also requires close cooperation between the newly appointed executive and finance director.
- ◆ Organizational changes and decentralization are established if the company is highly centralized, with the aim of achieving balance with the need for the establishment of financial control.
- ◆ The new product or market means that the company re-directs its strategy to market new products in order to ensure sustainable recovery.
- ◆ Improving marketing process represents a new approach - new strategy, which refers to the maximization of profit potential in the manufacturing segment of the market, in a way that involves setting the key elements of the marketing mix, such as price, product lines, distribution channels, sales, advertising services.



- ◆ Growth through acquisition of another company is widely used in stagnant companies, companies that are not in financial crisis, and those with the lower financial impact. Many companies consider acquisitions a way of improving the turnaround in its operations, as it is the quickest way of growth companies.
- ◆ The reduction of assets and costs implies that the company relies on the efficiency strategy, which includes the sale of unprofitable parts of the company.
- ◆ Investing, as one of the generic strategies, is common in situations where we have executed the acquisition with a company that has adequate financial resources. The investment strategy involves reducing costs through replacement of obsolete and worn-out plant and equipment, by promoting growth or through acquisitions.

The restructuring of debts and other financial strategies implies agreement between the heavily indebted companies and creditors, usually banks, with the intention to reschedule debts.

4. MEASURES AND SUGGESTIONS

Reorganization can be implemented in different ways and it may have different effects on future operations and degree of settlement of creditors. Definition of scenarios is a very important preparatory activity in reorganization, and it is recommended to consult all entities interested in doing business enterprises, especially the largest creditors. Defining scenarios for reorganization should be based on the preliminary consent of the majority of creditors or at least indication that they would accept the measures proposed and later adopted reorganization plan.

4.1. RECOMMENDATIONS

- ◆ Measures for promoting the production and sales of products and services, or measures for increasing the revenue and reducing expenses. These include the changes in production and commercialization of products and services, and may require investment in new capacity and the eventual sale of the property, which can not be used in the next period. The purpose of these measures is to repair profitability, ensure rational use of resources and increase the overall effectiveness in the field of manufacturing and commercial operations.
- ◆ Measures to modify the existing legal status and organization. These measures should support the implementation of the measures from the previous group, as it eliminates the existing problems and improves the overall operations of the company. They should also contribute to the strengthening of corporate governance.
- ◆ Measures to improve the financial situation, which is mainly related to the reduction of debt to the level that could enable successful continuation of business operations of the company and creditors of future results.
- ◆ Measures to promote the export strategy, which would target new markets to sell the company products *i.e.* develop one's profit through new products and new territories. Promotion and development of products is recommended in order to increase the quality, diversity and competitiveness in the market.
- ◆ Measures relating to changes in activity with a higher rate of profit.
- ◆ Measures with the emphasis on most profitable products, as well as switching from the Premium segment to Economy and Medium segment.

- ◆ Measures of more efficient use of marketing, through transition from TV advertising to Internet advertising and through more efficient display products that would contribute to increasing the competitive position in the market.
- ◆ Increase operational efficiency through introduction of planning at the customer's request, larger production series, reducing logistics costs through new distributors and centralized parts.
- ◆ Measures relating to the planned reduction of the organization through staff reductions. Firstly, it is necessary to perform job classification, which will be adjusted to the size of the organization, scope of work and available resources. This will have a direct impact on reducing costs, ensuring more effective implementation of decisions, and stimulating professional development of employees and greater contribution to the organization. Also, these measures should be aimed at improving human resources performances, which will allow the remaining employees to invest in their development within the organization, and prevent that appropriate measures and actions affect the decline of loyalty within the company.
- ◆ Measures related to reduction operations may represent a transitional solution for the companies that leave jobs, reduce the volume of business and the number of employees.
- ◆ Also, one of the important measures recommended is the sale of part of the non-core assets, encumbered and unencumbered for the settlement of claims. It is recommended that creditors write off part of their claims, with the application of the standstill arrangements.
- ◆ Significant measures need to be taken regarding the introduction of strategic partners who can provide working capital and improve corporate governance.
- ◆ Measure of joint venture represents a business combination which engages a certain volume of assets of the company in cooperation with other companies within a certain period of time (*e.g.* 10-15 years) with the aim to achieve common goals.
- ◆ Measures related to the steps that will be taken by the state for the purpose of controlling implementation of the adopted reorganization plan. It is necessary to provide external authorities that will carry out independent control of the enterprise and monitor the degree of fulfillment of the adopted reorganization proposals.

Certainly, when the company is choosing these measures, as well as defining the extent to which they will be applied, it is necessary to take into account that the creditors should be settled to a greater extent than in the case of bankruptcy. This means that the total amount of debt, after taking these measures, was returned to creditors of future results and therefore, it must be greater than the amount that would be obtained by selling the assets in the event of bankruptcy.

The purpose of these measures is to enable the company to do business successfully and meet its obligations that remain in its balance following the adoption of UPPR.

5. CONCLUSION

If the company is unable to meet its obligations, it is not necessary to immediately initiate bankruptcy. There is the possibility of implementing the Pre-pack Reorganization Plan as one of the models. According to the Law on bankruptcy, reorganization is implemented on the basis of the specially prepared



plan adopted by the majority of creditors. The development of the plan requires very extensive preparations, including the analysis and assessment of the situation in the most important spheres of business and defining of reorganization scenarios. It is necessary to make an assessment of the liquidation value of the property. If it is estimated that the creditors are charged in a larger scale after proceedings conducted by UPPR, it is necessary to define the essential scenario of the reorganization and the way of its realization. It is a very complex and time-consuming process, especially in the case of large companies, during which it should be checked whether the intended results have been achieved.

However, we should not forget the fact that UPPR, as a model of reorganization, should not be understood only as a drug that will immediately extend the life cycle of a company. Along with the development plan, the company should provide the grounds for the implementation of the planned recovery process upon the acceptance of UPPR. It is clear that unless significant change has been made, starting from the top, there will be no significant progress in the overall work and results. The suggestion is that the company adheres to the recommended methods for overcoming the crisis in order to be able to fulfil its future obligations on time.

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