

Iulian Boldea, Dumitru-Mircea Buda (Editors)
CONVERGENT DISCOURSES. Exploring the Contexts of Communication
 Arhipelag XXI Press, Tîrgu Mureş, 2016. Section: Social Sciences
 ISBN: 978-606-8624-17-4

SEVERAL COORDINATES CONCERNING INSOLVENCY AND INSOLVABILITY

Carmen Comaniciu, Prof., PhD
"Lucian Blaga" University of Sibiu

Abstract: Often, insolvency and insolvability are concepts that have created confusion by their meaning, but not identical. Although, both concepts refers to the financial situation of legal entities or individuals, current legal regulations, as well as the judicial and the financial-accounting practice are able to delineate the insolvency of insolvability. Without claiming an exhaustive approach, through this article we will identify the main aspects that differentiates the two procedures intended to resolve certain owed obligations, with reference to the conceptual delimitations, the stages of each procedure, patrimonial situation and lack of funds, the future of entity, commercial registers as probative elements.

Keywords: insolvency, insolvability, patrimonial situation, cash funds, judicial reorganization

1. Introduction

Commonly used in the economic and juridical area, insolvency and insolvability are two concepts that often create confusion by their meaning. For a clear delineation of them, must be considered the defining elements. In Romania, the insolvency benefits from a legal definition by Law no. 85/2014 concerning the procedures to prevent insolvency, by reference to the general term insolvency, to the insolvency of the credit institution and to the insolvency of the insurance/ reinsurance company. Insolvability does not have a legal definition, but issues concerning the insolvability state are found in the provisions of the New Civil Code and the Code of Fiscal Procedure. By issues highlighted in this article, we will try to provide answer to questions such as: What is insolvency? What is insolvability? How to avoid the risk of default? What methods can be used to prevent insolvency and insolvability? Thus, we want through answers provided to highlight the main elements that delimit the insolvency and the insolvability.

2. Conceptual aspects of insolvency and insolvability

The beneficial effect of any insolvency laws will be visible that the content of the law provided: insolvency is clearly defined in legal terms, collective procedures are consistent established, is clearly establishes the order for payment of debts, are provided elements of transparency and security, it is stated the concrete way to implement the procedures by competent institutions(Foster, 2013).

In Romania, insolvency is defined as the status of a debtor which has insufficient cash funds available to pay certain and chargeable debts, it being imminent when proof is furnished that

Iulian Boldea, Dumitru-Mircea Buda (Editors)
CONVERGENT DISCOURSES. Exploring the Contexts of Communication
Arhipelag XXI Press, Tîrgu Mureş, 2016. *Section: Social Sciences*
ISBN: 978-606-8624-17-4

the chargeable debts can not be paid with the funds available on the due date (Law no. 85, 2014). From the general definition of insolvency, the legislature refers to the insolvency of the credit institution and the insolvency of the insurance/ reinsurance company, specifying the circumstances in which we can define such a state, the mostly differences come from the value of the solvency margin.

Although for insolvability, in Romania there is no legal definition, a meaning to this juridical concept is found in the provisions of the New Civil Code, where the insolvability state presupposes inferiority of the patrimonial assets to the total amount of chargeable debt (New Civil Code of Romania, 2016) and in the provisions of the Fiscal Procedure Code, where the debtor is insolvent when pursuable revenues or assets are worth less than the outstanding tax obligations (Law no. 207, 2015).

From the definitions of these two juridical concepts (insolvency and insolvability) and in closely connected with the concept of bankruptcy, can be drawn the following aspects (Appraisal & Valuation, 2011): insolvency is caused by lack of funds and the assets owned by the debtor has no relevance, while insolvability is a financial imbalance, where the patrimony passive component is larger than the active component; the insolvency state can trigger the procedure for termination of the existence of an entity; are clearly specified circumstances where an entity is in an insolvency state, depending on the field of activity; insolvency can be both manifest and imminent; in terms of state assets, both insolvency and insolvability are procedures which aims payment of certain owed obligations.

3. Insolvency Procedure - financial recovery instrument or tool for enforced execution

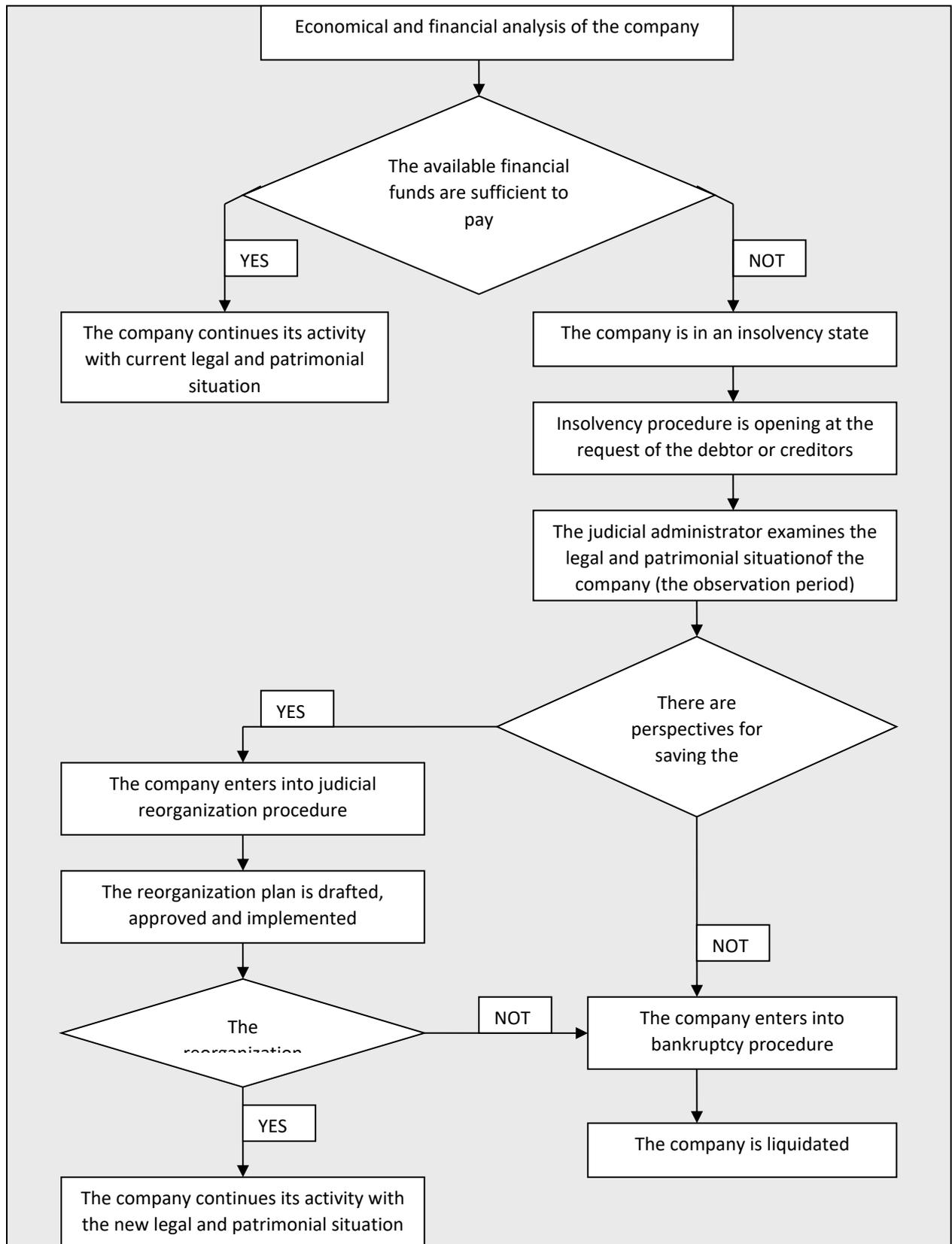
Area of insolvency can be regarded particularly complex, considering the fact that insolvency proceedings can be both a financial remedy of the debtor, and a tool for its forced execution (Nemes, 2012), taking into account national and international framework.

Insolvency proceedings should not be seen as a sequence of steps which must be achieved within a certain time, but as a tool capable of ensuring financial redress of the company (Smrčka, Schönfeld, Arltová and Plaček, 2014).

If an entity is in an insolvency state, at the request of the debtor or creditors it is opening the insolvency proceedings, which can be considered a procedure umbrella, because it includes the reorganization proceedings and / or bankruptcy proceedings (Coltuc, 2013).

Starting from the aspects of economic and financial analysis, an entity state can be depicted using a flowchart, as shown in the following figure.

Iulian Boldea, Dumitru-Mircea Buda (Editors)
CONVERGENT DISCOURSES. Exploring the Contexts of Communication
 Arhipelag XXI Press, Tîrgu Mureş, 2016. Section: Social Sciences
 ISBN: 978-606-8624-17-4



Iulian Boldea, Dumitru-Mircea Buda (Editors)
CONVERGENT DISCOURSES. Exploring the Contexts of Communication
 Arhipelag XXI Press, Tîrgu Mureş, 2016. *Section: Social Sciences*
 ISBN: 978-606-8624-17-4

Fig. no. 1 Status of a company

(Source: author processing)

To prevent insolvency, it is recommended not treating it as a situation but as a process. Thus, it is noted the particularly important role of the analysis of relations between performance of a company and endogenous and exogenous environmental variables (Levratto, 2013).

The possibility of redress an entity in an insolvency state presupposes proposal of a viable reorganization plan, taking into account the entity's financial analysis and diagnosis, the confidence of creditors and the causes that led to insolvency state (Danaila, 2013).

In Romania, the opening of insolvency proceedings (citations, convocations, notifications, communications, judicial judgments, decisions of the insolvency administrator) it is found from 01.08.2006 in the Insolvency Bulletin, a publication edited by the National Trade Register Office (NTROR, 2016a).

Thus, according to statistical data, the negative impact of the financial crisis is visible both through the number of companies became insolvent (NTROR, 2016b), as shown in Fig. 2, and through the number of applications published in the Insolvency Bulletin for procedural documents issued by courts, insolvency practitioners and authorized persons, as shown in Fig. 3.

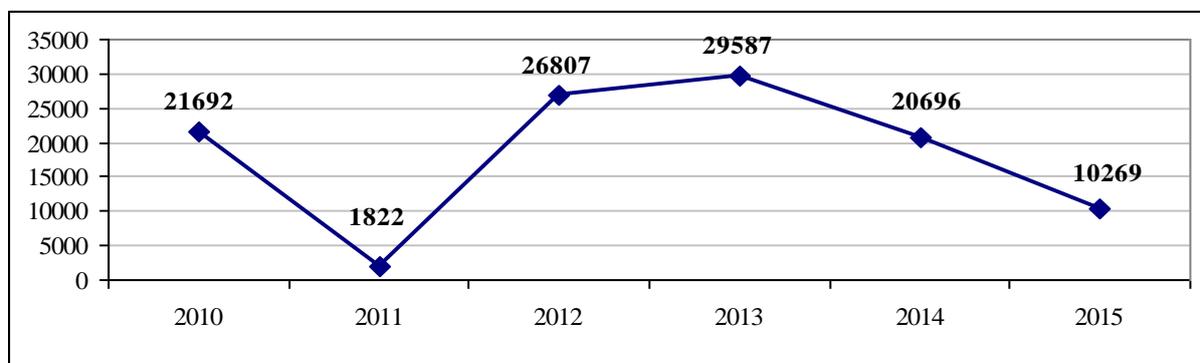


Fig. no. 2 Evolution of the number of companies became insolvent

(Source: National Trade Register Office of Romania)

According to the analysis it is found that most requests for publication in the Insolvency Bulletin were recorded in 2012-2014. The sad fact is that, of all requests publishing the percentage of reorganization plans is very low (at the level of 2013, this ratio was 0.08%) which led to the deletion of a significant large number of companies from the National Office of Trade Registry. Thus, in the period 2008-2015 were deleted from the Trade Register Office of Romania a total of 629,070 companies (NTROR, 2016c), most deletions were recorded in 2010 (171,146 radiated companies) and in 2015 (94,374 radiated companies).

At the opening of an insolvency procedure shall be made an analytical report to be identified the main causes that have generated the situation. Because in very few situations

Iulian Boldea, Dumitru-Mircea Buda (Editors)
CONVERGENT DISCOURSES. Exploring the Contexts of Communication
 Arhipelag XXI Press, Tîrgu Mureş, 2016. *Section: Social Sciences*
 ISBN: 978-606-8624-17-4

insolvency of a company is due to a single cause, the management teams can anticipate insolvency state taking into account elements such as consumption trends, the evolution of losses, changes in the indebtedness over real ability to pay, the negative impact of certain managerial decisions. In the situation where the insolvency is declared without this analysis, considerably decreases the company chance for recover.

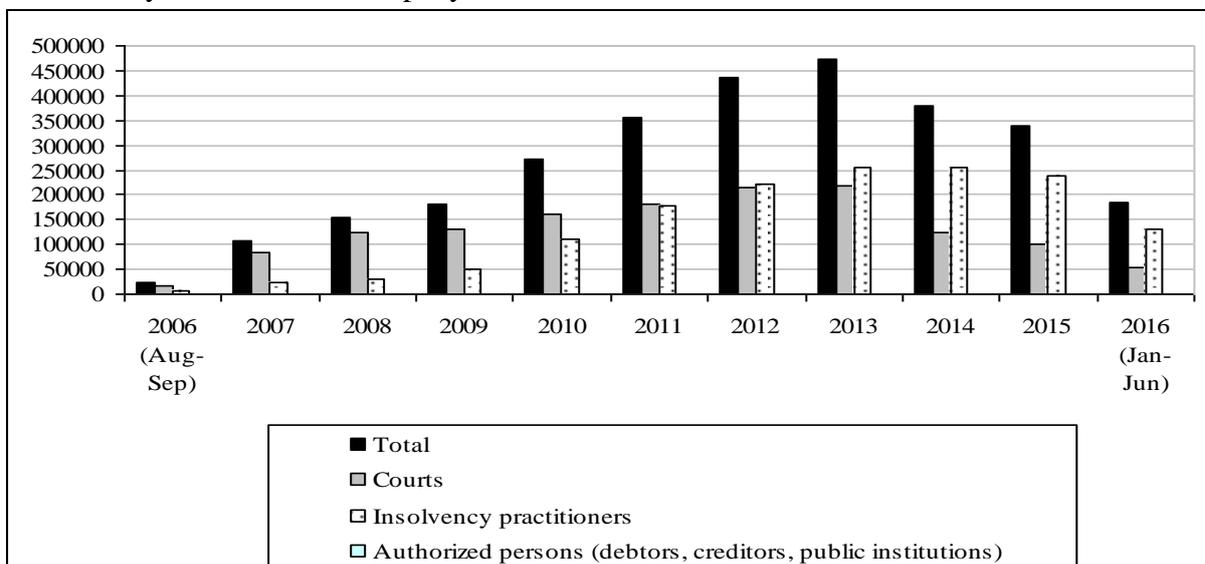


Fig. no. 2 Evolution of the number of requests for publication in Insolvency Bulletin
 (Source: Bulletin Insolvency, Statistics)

The bankruptcy of a company places the debtor and creditors in antagonistic position, the company wishing maintenance in commercial life and creditors seeking full recovery of the claim.

In this respect, it is recommended that through the reorganization plan to be identified relevant and realistic elements related to: total revenue under the judicial reorganization plan, according with cash-flows calculated; total revenue in case of bankruptcy, consisting most often out of revenues from sales of assets at liquidation values reduced compared to market values; current expenditure made under judicial reorganization plan, according with cash-flows calculated; current expenses of liquidation by selling assets; required cash flow for debts payment under the judicial reorganization plan; required cash flow for debts payment in case of bankruptcy; the coverage of debts towards the creditors under judicial reorganization; the coverage of debts towards the creditors in case of bankruptcy.

4. How can it be prevented insolvability?

According to the Juridical Dictionary, insolvability of a debtor consists in the impossibility to fulfill its obligations towards its creditors, either from lack of liquidity or lack of other goods, respectively a situation where the debtor's liabilities it is greater than its assets (Juridical Dictionary, 2016).

Iulian Boldea, Dumitru-Mircea Buda (Editors)
CONVERGENT DISCOURSES. Exploring the Contexts of Communication
 Arhipelag XXI Press, Tîrgu Mureș, 2016. *Section: Social Sciences*
 ISBN: 978-606-8624-17-4

If the answer at question “Insolvency can be anticipated?” is Yes, then must be identified the methods and techniques for anticipating this situation. In this sense, economic and financial analysis is one that is essential and indispensable to any company, both in terms of financial balance and the prospects for development. Being the basic instrument in the diagnosis and control of enterprise activity, economic and financial analysis aims to establish causal links between factors by systemic addressing of the economic and financial phenomena and processes (Pavaloaia, 2010).

To prevent the insolvency of a company, the management team must consider the value brought by the use of indicators in an economic and financial analysis, since it enables evaluation of the performances of past, assess the current financial situation of the company and obtaining useful insights in predicting future results.

In this respect it is recommended that each company regularly appeal to this operational tool, respectively to this method of knowledge (Baltes et al, 2013), taking into account:

- economic and financial analysis typology (the moment of development, the essential characteristics of the phenomenon or process analyzed, the level at which takes place the phenomenon or process analyzed, evolution of the phenomenon or process, objective of research);
- the contents of the economic and financial analysis (object of the analysis, factors influence the phenomenon or process analyzed, decisions and measures for improvement);
- the qualitative and quantitative methods and techniques of economic and financial analysis (concordance method, method by difference, combined method, concomitant variation method, balance method, comparison method division and decomposition method, grouping method, generalization and evaluation method, chain substitutions method, matrix calculation method, correlation method, operational research);
- the basic issue of the company's activity (analysis of production activity, trading activity analysis, fixed asset management analysis, material resources management analysis, analysis of human resource management, analysis of expenditure and income financial performance analysis, analysis of financial position financial equilibrium analysis, cash flow analysis, equity capital analysis, risk analysis).

Without claiming an exhaustive approach, we believe that the insolvency of a company can be prevented if we analyze: self-financing capacity of the company (patrimonial solvency ratio); the company's financial independence (financial autonomy rate); the proportion of total debt financing of the company based on equity capital (overall indebtedness); the contribution of the company's assets to its total debt financing (overall solvency ratio); short-term financial equilibrium (current liquidity ratio); the ability of current assets of the company to honor outstanding liabilities in the short term (immediate liquidity ratio); society's ability to honor its short-term obligations on cash and cash equivalents and on short term financial investments (actual liquidity ratio); the contribution of assets to get the results (economic rate of return);

Iulian Boldea, Dumitru-Mircea Buda (Editors)
CONVERGENT DISCOURSES. Exploring the Contexts of Communication
 Arhipelag XXI Press, Tîrgu Mureş, 2016. *Section: Social Sciences*
 ISBN: 978-606-8624-17-4

efficiency of use the capital invested by shareholders (financial rate of return); the total resource consumption (rate of overall profitability); using performance of capital employed in the business (the ratio of equity capital and social capital); the effectiveness of the company's equity capital to realization of profits (the ratio of profit to equity capital).

Along with the analysis of these indicators and application of the classical models based on method of scoring (Altman model, Conan-Holder model, Loeb and Partier model, and so on), for analyzing the bankruptcy risk are noteworthy recent research from specialized literature, such as: the link between productivity, company strategy and the risk of bankruptcy (Bryan, Dinesh Fernando and Tripathy, 2013); the contribution of accounting conservatism to reducing the risk of bankruptcy (Biddle, Kim, Ma and Song, 2015); applicability of fuzzy SWOT analysis for bankruptcy risk management (Zakharova, 2013); using multiple criteria decision-making in evaluating clustering algorithms in the analysis of financial risk (Kou, Peng, and Wang, 2014); the spline functions role in the relationship between bankruptcy risk, leverage effect, the earnings and liquidity (Giordani, Jacobson, von Schedvin and Villani, 2014).

5. Insolvency Practice at EU Member States

Whereas most countries were faced with insolvency issues, Doing Business provides a database with information on best practices in insolvency so that each government to be able to find solutions to improve regulation in this area. According to data collected and centralized in June 2015 for 189 jurisdictions, Romania held the position 46 in terms of resolving insolvency (Doing Business, 2015).

Although at EU level there is a common framework for insolvency proceedings, which establishes common rules on legal regulation and competences for insolvency proceedings (European Commission, 2016), in practice there are both similarities and differences (Doing Business, 2015), namely:

- in all EU Member States, the procedures available to a debtor to start insolvency proceedings are both liquidation and reorganization;
- while in Austria, Belgium, Bulgaria, Estonia, Greece, Hungary, Latvia, Lithuania, Luxembourg, Malta, Netherlands and Slovenia, a creditor may request the debtor's insolvency only for liquidation in other Member States, a creditor may request the debtor's insolvency, both for liquidation and reorganization;
- in most EU Member States, the insolvency framework allow the continuation of contracts supplying essential goods and services to the debtor, with the exception of Luxembourg, Malta and United Kingdom;
- the insolvency framework allow the rejection by the debtor of overly burdensome contracts to most EU Member States, except Luxembourg and Malta;
- only in Latvia, the insolvency framework does not allow avoidance of preferential transactions;
- the insolvency framework does no allow avoidance of undervalued transactions in Cyprus and Ireland;

Iulian Boldea, Dumitru-Mircea Buda (Editors)
CONVERGENT DISCOURSES. Exploring the Contexts of Communication
 Arhipelag XXI Press, Tîrgu Mureş, 2016. *Section: Social Sciences*
 ISBN: 978-606-8624-17-4

- in most EU Member States, the insolvency framework provide for the possibility of the debtor obtaining credit after commencement of insolvency proceedings, except Bulgaria, Croatia, Lithuania, Malta and Slovak Republic;
- if in Bulgaria, Cyprus, Finland, Hungary, Ireland, Latvia, Lithuania, Luxembourg, Poland and Romania all creditors vote on the proposed reorganization plan, in Austria, Belgium, Croatia, Czech Republic, Denmark, Estonia, France, Germany, Greece, Italy, Netherlands, Portugal, Slovak Republic, Sweden and United Kingdom only creditors whose rights are affected by the proposed plan can vote on the proposed reorganization plan;
- in Bulgaria, Croatia, Cyprus, Czech Republic, Finland, Germany, Greece, Italy, Latvia, Poland, Portugal, Romania, Slovak Republic and Slovenia the insolvency framework require that dissenting creditors in reorganization receive at least as much as what they would obtain in a liquidation;
- in Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Finland, Germany, Greece, Ireland, Italy, Latvia, Poland, Portugal, Romania, Slovak Republic and Spain the creditors are divided into classes for the purposes of voting on the reorganization plan, so each class vote separately and creditors in the same class are treated equally;
- for selection or appointment of the insolvency representative, in Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, Germany, Italy, Latvia, Malta, Portugal, Romania, Slovak Republic and United Kingdom the insolvency framework require approval by the creditors;
- only in Austria, Bulgaria, Estonia, Germany, Portugal and Slovak Republic the insolvency framework require approval by the creditors for sale of substantial assets of the debtor;
- in most EU Member States, the insolvency framework does not provide that a creditor has the right to request information from the insolvency representative, except Belgium, Bulgaria, Cyprus, Estonia, Finland, Netherlands and Sweden;
- in all EU Member States the insolvency framework provide that a creditor has the right to object to decisions accepting or rejecting creditors' claims.

6. Conclusions

If insolvency, defined as insufficiency of funds to pay chargeable debts, it refers to debtor's subjective way for the characterization of his economic status, termination of payments is the objective expression of the state of insolvency (Stefan, 2011). Thus, it requires the existence of a legal framework on insolvency proceedings clearly and concisely, in order to be a tool equidistant between the insolvent debtor and its creditors, designed to give the best solution for state of insolvency, and from the perspective of the debtor, to succeed its rehabilitation and his return to normal activity.

Since bankruptcy is not a brutal phenomenon, but a result of a progressive deterioration of the financial situation of the company, the risk of insolvency may be predictable, provided that are properly used the methods and tools of economic and financial analysis.

Iulian Boldea, Dumitru-Mircea Buda (Editors)
CONVERGENT DISCOURSES. Exploring the Contexts of Communication
 Arhipelag XXI Press, Tîrgu Mureş, 2016. Section: Social Sciences
 ISBN: 978-606-8624-17-4

We believe that, through the aspects presented in this article, is highlighted once again that insolvency should not be confused with insolvability, but the insolvability treatment without earnestness could lead to insolvency, sometimes without the possibility of recovery.

7. References

- Appraisal & Valuation (2011). *Distinction between insolvency and bankruptcy (Distincție între insolvență și faliment)*, available online at <http://www.a-v.ro/detalii.php?id=21>
- Baltas, N., Comaniciu, C., Herciu, M., Ciuhureanu, A.T., Sava, R., Bratian, V., Taran Morosan, A. (2013). *Economic and financial analysis of the company. Second edition, revised and enlarged (Analiza economico-financiara a intreprinderii. Editia a II-a, revizuita si adaugita)*, Publisher of "Lucian Blaga" University, Sibiu, Romania, 11-22.
- Biddle, G. C., Kim, J. B., Ma, M. L., Song, F. M. (2015). *Accounting conservatism and bankruptcy risk*, available at SSRN 1621272.
- Bryan, D., Dinesh Fernando, G., Tripathy, A. (2013). *Bankruptcy risk, productivity and firm strategy*. Review of Accounting and Finance, 12(4), 309-326.
- Coltuc, M. (2013). *Some useful information about insolvency, bankruptcy and judicial reorganization (Cateva informatii utile despre insolvență, faliment și reorganizare judiciară)*, available online at <http://legestart.ro/>
- Danaïla, R. (2013). *The rules of a good plan of reorganization (Regulile unui bun plan de reorganizare)*, available online at <http://www.capital.ro/181847.html>
- Doing Business (2015). [Resolving Insolvency](http://www.doingbusiness.org/data/exploretopics/resolving-insolvency), available online at <http://www.doingbusiness.org/data/exploretopics/resolving-insolvency>
- (European Commission (2016). *Building a European Area of Justice. Insolvency Proceedings*, available online at <http://ec.europa.eu/justice/civil/>
- Foster, N. H. (2013). *Operating with a Truncated Legal System: Financial Law without Insolvency Law*. SOAS Law of Islamic Finance Working Papers Series, (5), 1-5.
- Giordani, P., Jacobson, T., von Schedvin, E., Villani, M. (2014). *Taking the twists into account: Predicting firm bankruptcy risk with splines of financial ratios*. Journal of Financial and Quantitative Analysis, 49(04), 1071-1099.
- Juridical Dictionary (2016). *Insolvability*, available online at <http://legeaz.net/dictionar-juridic/insolvabilitate>
- Kou, G., Peng, Y., Wang, G. (2014). *Evaluation of clustering algorithms for financial risk analysis using MCDM methods*. Information Sciences, 275, 1-12.
- Law no. 85 (2014). *Law concerning the procedures to prevent insolvency and of the insolvency*, available online at <http://lege5.ro/>
- Law no. 207 (2015). *Law regarding the Fiscal Procedure Code*, available online at <https://static.anaf.ro/>
- Levratto, N. (2013). *From failure to corporate bankruptcy: a review*. Journal of Innovation and Entrepreneurship, 2(1), 1.

Iulian Boldea, Dumitru-Mircea Buda (Editors)
CONVERGENT DISCOURSES. Exploring the Contexts of Communication
Arhipelag XXI Press, Tîrgu Mureş, 2016. Section: Social Sciences
ISBN: 978-606-8624-17-4

- Nemes, N. (2012). *Commercial law (Drept comercial)*, Hamangiu Publishing House, Bucharest, p.435.
- New Civil Code of Romania (2016), available online at <http://lege5.ro/>
- NTROR - National Trade Register Office of Romania (2016a). *Insolvency Bulletin*, available online at <http://www.bpi.ro/>
- NTROR - National Trade Register Office of Romania (2016b). *Companies became insolvent*, available online at <http://www.onrc.ro/index.php/ro/statistici?id=252>
- NTROR - National Trade Register Office of Romania (2016c). *Cancellations*, available online at <http://www.onrc.ro/index.php/ro/statistici?id=251>
- Pavaloaia, W. (2010). *Financial and economic analysis. Concepts and case studies (Analiza economico-financiară. Concepte și studii de caz)*, Economic Publishing House, Bucharest, 5.
- Smrčka, L., Schönfeld, J., Arltová, M., Plaček, J. (2014). *The significance of insolvency statistics and the regression analysis thereof—the example of the Czech Republic*. WSEAS Transactions on Business and Economics, 11, 227-241.
- Ștefan, I.R. (2011). *The debtor in insolvency proceedings (Debitorul în procedura insolvenței)*, PhD thesis, University "Babes Bolyai" Cluj Napoca, Romania, available online at: http://doctorat.ubbcluj.ro/sustinerea_publica/.../stefan_ioana_roxana_ro.pdf
- Zakharova, A. A. (2013). *Fuzzy swot analysis for selection of bankruptcy risk factors*. In Applied Mechanics and Materials (Vol. 379, pp. 207-213). Trans Tech Publications.