

IT'S TIME TO CHANGE THE ASIAN MINDSET ABOUT CORPORATE RESTRUCTURING

Western financial centres see insolvency proceedings as gateways to potential business rescue. In Asia, insolvency is seen as a procedure ending in liquidation.

IN ASIA, there has traditionally been a stigma associated with corporate insolvencies. The taint of insolvency can be hugely value-destructive; it can destroy the goodwill of the business, and brand the managers and controllers as failures and social outcasts.

Culturally, the problem is exacerbated by the dominance of family-controlled businesses, whose patriarchs or honchos are held in high esteem by the business community – and for whom the stigma associated with insolvency can often be unpalatable.

While there has been a gradual global shift from viewing insolvency strictly as a terminal procedure leading to inevitable liquidation, to recognising insolvency proceedings as a gateway to potential business rescue, this mindset change is largely limited to the leading Western financial centres, such as those in the United States and the United Kingdom.

In most of Asia, the negative cultural perception of insolvency remains.

The time is ripe to change this cultural mindset. The economic devastation wrought by the Covid-19 pandemic will force many companies to confront squarely the need for effective corporate debt restructuring and turnarounds. We discuss three areas that may lead to a mindset shift.

A TRACK RECORD OF SUCCESS

Historically, insolvency laws and ecosystems in many Asian jurisdictions have been woefully underdeveloped. There has also been little

uniformity of approach across countries, as the laws across Asia are a patchwork of civil and common law systems. Given that most modern businesses are cross-border in nature, this has made effective restructuring a challenge. Given the high failure rates and inefficiencies associated with previous cases of companies going through formal restructuring processes, it is unsurprising that this has created a negative impression.

Given that the economic slowdown caused by the Covid-19 pandemic has hit many businesses, this is an opportune time to showcase the ability of Singapore's modern restructuring laws and framework to rescue and rehabilitate companies.

Singapore's concerted drive in recent years to position itself as the leading Asia debt restructuring hub has been widely publicised. Its restructuring framework has been enhanced to make it relatively easy for foreign companies to commence formal restructuring proceedings in Singapore.

Additionally, features such as the statutory moratorium (against legal actions and enforcement of securities, for example) with extra-territorial impact, the provision to extend the moratorium to certain related companies in the same group, and to execute a cramdown on dissenting creditors via a scheme of arrangement, as well as the rescue financing provisions – are all but examples of the useful toolkit that distressed companies can avail themselves of if they restructure in Singapore.

Singapore is not the only country in the region that has sought to modernise its restructuring laws. A notable example is neighbouring Malaysia, which has taken concrete steps to introduce corporate rescue mechanisms, including corporate voluntary arrangements

and judicial management, via recent amendments to their Companies Act; India has also made recent amendments to its Insolvency & Bankruptcy Code.

Separately, the slow but steady adoption by more countries in Asia of the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross Border Insolvency, as well as judiciary-led innovations such as the Judicial Insolvency Network (JIN) guidelines mean that we can expect to see increasing cooperation and coordination across jurisdictions on cross-border insolvency matters.

As a matter of necessity, it is likely that more Asian companies will avail themselves of these formal restructuring mechanisms. The efficacy of these mechanisms will be tested. If successful, the positive experience of companies that restructure and re-emerge as reinvigorated businesses in these challenging times, will go a long way towards removing the stigma of corporate stigma associated with insolvency processes.

PROVIDING VALUE

Whether a restructuring is ultimately perceived to be successful is inextricably tied to the ability of service providers and the court system to bring real value to the stakeholders. Among other things, this will include moderating divergent needs of the various creditors, preserving enterprise value, and the ability to raise new monies.

At a minimum, legal and financial professionals who service the stakeholders involved will have to adeptly perform the following functions:

- Educate stakeholders on the informal and formal restructuring options available to them in a commercially sensitive manner;
- Manage delicate negotiations and balance varied stakeholders' interests;
- Commence and utilise the available court processes effectively.

Where recourse from the courts is sought, there must be confidence that the matter will be dealt with by a specialised insolvency judge who is efficient and commercially attuned.

As the experience of more mature restructuring jurisdictions (such as the United States) has shown, the availability of able professionals and an effective court system are the sine qua non of an effective restructuring.

At the same time, it is also important to be mindful of criticisms that have emerged of the US Chapter 11 regime, in particular, of the high costs associated with it. In order that there is value, the costs involved must be commensurate with the level of service provided. Ultimately, each restructuring is different and the costs involved will depend on the complexity, scale and length of the restructuring. However, restructuring professionals should always be conscious of the need to provide real value – all the more so given that they are dealing with a distressed situation.

It is only when the wider business community recognises the value brought by the restructuring process that perceptions will change.

CREDIT MARKETS

As credit markets and capital structures in Asia become more complex, we can expect to see increased use of restructuring processes. In particular, given that companies across the region have raised a significant amount of debt capital through the international bond markets in the past few years, the involvement of more sophisticated institutional bondholders may push distressed borrowers to restructure in established legal markets such as Singapore and Hong Kong.

We also anticipate distressed players becoming more active in Asia, as asset prices in the region start to become depressed. Many of these distressed players have experience with more sophisticated regimes and may demand that borrower companies undergo formal restructuring as a condition for injecting new monies.

The need to maintain continued access to credit markets in these challenging conditions will likely compel many companies to engage in formal restructuring. As this practice becomes more widespread, there will, it is hoped, be a mindset shift to recognising restructuring as performing a necessary and critical function in a properly functioning credit market.

INTERESTING TIMES AHEAD

The next couple of years are likely to be interesting times in the development of restructuring practice in the region. We are optimistic that the existing laws and ecosystems in place across Asia will be more than up to the task, and that there will be a sea change in the cultural perception of restructuring and insolvency in the region.

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If you require assistance for any restructuring & insolvency matters, please do not hesitate to get in touch with:



Meiyen Tan 
Head of Restructuring & Insolvency

meiyen.tan@oonbazul.com
DID + 65 6239 5898



Keith Han 
Partner

keith.han@oonbazul.com
DID + 65 6704 1903

www.oonbazul.com 

Oon & Bazul LLP
36 Robinson Road,
#08-01/06 City House,
Singapore 068877
Tel (65) 6223 3893
Fax (65) 6223 6491

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