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Insolvency law in emerging markets

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Corporate insolvency law can serve as a powerful mechanism to promote economic growth. Ex ante, a well-functioning insolvency framework can facilitate entrepreneurship, innovation and access to finance. Ex post, corporate insolvency law can perform several functions, including the reorganization of viable companies in financial distress, the liquidation of non-viable businesses in a fair and efficient manner, and the maximization of the returns to creditors. Therefore, if having an efficient corporate insolvency framework is essential for any country, it becomes even more important for emerging economies due to their potential for growth and their greater financial needs.

Unfortunately, the academic literature has generally paid more attention to the regulation of corporate insolvency in developed countries. Thus, it has largely omitted the debate about the optimal design of insolvency law in jurisdictions that, in addition to requiring a more active policy debate, amount to 85% of the world's population and 59% of the global GDP, since they include some of the world's largest economies such as China, India, Brazil, Russia and Indonesia.

In my new article, 'Insolvency Law in Emerging Markets', I seek to fill this gap in the academic literature by analyzing the problems and features of insolvency law in emerging economies and suggesting a new framework for financially distressed companies in these countries. My paper argues that, even though, in an ideal scenario, any improvement of the insolvency framework in these countries should start by enhancing the judicial system and the sophistication of the insolvency profession, these reforms usually take time, resources and political will. In fact, due to a variety of factors, including corruption, lack of awareness about the importance of the insolvency system for the real economy, or lack of political incentives to engage in such complex reforms whose benefits will only be shown in the long run, they might never occur. For this reason, my paper suggests an insolvency framework for emerging economies taking into account the current market and institutional features of these countries. If these conditions change over time, or they do not exist in some particular emerging economies, my proposal would need to be adjusted accordingly.

My proposed corporate insolvency framework for emerging markets is based on three fundamental pillars. First, pre-insolvency proceedings and out-of-court restructuring should be promoted as a way to avoid an insolvency system that is usually value-destroying for both debtors and creditors. Second, insolvency proceedings should be reformed to respond more effectively to the problems and features existing in emerging markets, which generally include the prevalence of small companies and large controlled firms, as well as the existence of inefficient courts and unsophisticated insolvency practitioners. Finally, emerging economies should adopt a more contractual approach to deal with a situation of cross-border insolvency. Thus, by facilitating the choice of insolvency forum, debtors, creditors and society as a whole will be able to enjoy the benefits associated with having access to more sophisticated insolvency frameworks. Besides, since many debtors and creditors would be using foreign insolvency proceedings, this value-creating forum shopping may incentivize many Governments in emerging economies to invest the resources needed to improve the market and institutional environment existing in these countries, hopefully making the insolvency framework suggested in this article no longer needed.

The full article is available here.

Another version of this post was previously published on the Oxford Business Law Blog and the Singapore Global Restructuring Initiative Blog.