A Concept of Insolvency and Financial Difficulty Strategy

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Abstract: Insolvency and financial Difficulty is a practical condition that threatens imperfect firms’ pragmatic performance and undulating productivity. The research identifies sources of insolvency and causable berried with suggestions to improve it. The concept is different from others which use ‘insolvency’ to represent the style of long-term strategic behavior. Insolvency and financial difficulty strategy is experienced by firms in lesser or greater frequency depending the capacity of the firm to manage its resources. It is observed that, such a strategy will be seen occurring in cycles in each department to reflected choice of basic moves of strategy. The study closes on discussion of cycles and conclusion.

INTRODUCTION

The study provides useful information on the insolvency law highlighting the steps to use in minimizing the risk of personal liability by directors in the eventualities of financial crises or insolvency. “It begins by listing the relevant duties of directors. These duties can be thought of as the legal principles of standards a director will be judged by”(e.g. Webster, 2005 P. 150). As every environment is strictly surrounded by rules and regulation of law, so are directors bound with the laws of ethics-rules and regulations, code of conducts and rule of law in general. Every director is subject to law irrespective of ownership or non ownership. This is the condition that binds them from potential stealing, malpractices, mafleasance, misappropriations and wrongful trace practice. A responsible director conducts him/herself as a faithful steward, keep his/her hands clean from theft, wrongful suggestions, allegations of aiding and abetting, over pricing of control carefully takes advice, sides critical decisions with the board, serves in the interest of share holders and company creditors and finally saves the company from unproductiveness and financial collapse. Directors ought to live within the limit of actionable responsibilities in best discharge of their duties. Breaches of duties amounts to legal actions that can be taken against them as well as remedies against delinquent directors. The study reveals the various forms of insolvency procedure-options legally when an organization is unable to pay its debts. The introduction is not an exhaustive of the “big picture” of insolvency but rather, a directional summary of the main points. In all circumstance, professional advice should be sought to demonstrate integrity.

THE ELEMENT OF A CONCEPT

“The behavior of an organization may be understood by examination of four sets of system interdependencies-environmental, organizational and the input-output interrelationships, connecting organization with environment” (Emery, and Trist,1972) (quoted: Murray, 1984). “Within this system of interrelationships, the purpose of an organization is shaped. Purpose is used here in the manner of Ackoff and Emery (1972) to denote the ideal-seeking level in system behavior - the level that choose what it is the system wishes to be: what ideal state it prefers, and will continuously attempt to approach” (quoted from: Murray, 1984). “From this choice of valued ends springs the necessity for strategy from means to achieve the chosen ends. Ends are not the subject of much attention in the management literature” (Murray 1984). Organizations must operate in favorable environment and be sound to operate whatsoever however, it must be resourceful to reap higher productivity at all cost if directors do their duties above expectation.

Good environment is a pleasure for business stability and growth while growth also depends on how resourceful the organization is in terms of input to general expected output to achieve the goal of solvency. Without the above four elements, no organization can survive in the discharge of effective duties. The following factors support an organization for a speedy developmental growth:

- When a company is clearly solvent, directors must act in the interest of the shareholders in general. When a company is insolvent, or possibly even when it is of doubtful solvent, the position changes.
- All directors should separate their own personal interest (as shareholder, executive, creditor etc.) from the company’s interests. Their duty is to act in...
the interests of the company. This will mean following the principles that minimize the risks of liability” (Webster, 2005 P. 150)

- It is important for directors to competently avoid loss to company creditors. The insolvency legislation indicates that, every director will be liable for whatever comes from wrongful trading. (e.g. Webster, 2005 p. 150) stated that; “Liability will not arise of the director can show (to the court’s satisfaction) that they took every possible step to minimize the potential loss to the company’s creditors”. Director must be seen to be sufficiently competent however, not give chance for a company to receive credit which they have seen to be unreasonable e.g. payment made to creditors within the shortest time when payment of debt becomes due.

- Insolvency legislation directs that a liquidator or an administrator to seek court order to defer to change transactions at the undervalue including preferences made at a time before proceeding of insolvency begins. (Webster, 2005 p.151) explained; “In setting a transaction aside, a court will make an order to restore the position to what it would have been had the transaction not taken place. This may result in personal liability for the directors of the company and disqualification of proceedings against any director responsible for the transaction concerned”.

**PATTERNS OR CYCLES?**

“If an enterprise is an homogenous strategic whole (as on the case of a single-product-market firm, I seems reasonable to hypothesize that one will observe cycles”(Murray 1994); of insolvency and financial difficulty “behavior interspersed with periods of consolidation and efficiency-maximization as return on investment and positive cash flows are pursued” (e.g. Murray, 1994).

From the organizational analysis in details (e.g. Murray 1994) reiterated that “however if an enterprise is constructed as portfolio of resource commitments-when consisting of a product portfolio alone or of product portfolio rested within strategic business units which may in turn be nested within a cooperate business portfolio-then it may be hypothesized that one will observe strategic behavior of both” and insolvency and financial freedom nature taking place concurrently. It is clear that elements of the portfolio will pinpoint and stigmatize on maximization of efficiency whilst other aspects on increasing long-run effectiveness. “It is one of the great values of the spread and application of portfolio concepts that management can live with, and design for, this level of complexity. However it is not at a clear that the full implications of such strategic diversity of behavior with the corporate portfolio are, as yet, fully appreciated” (e.g. Murray, 1994). The differential capacity of management is due to diversity in culture. The level of each cultural style of comprehension varies from an individual to an individual including the geographical area of emergence directly or indirectly affects the stewardship of an industrial firm. This guarantees the reason why a set of directors may run a company into insolvency and financial hardships but another set will lead effectively into solvency and financial incremental stability. “The strategic management problem is then further complicated by the probable existence, in a diversified portfolio, of business units at varying stages of development, necessitating a variety of operating structures” (e.g. Murray, 1994). Enterprise with a complex structure may sometimes follow a continual behavior in the solvency or insolvency mode.

**Minimizing the risk of Liability**

Directors are responsible for reducing risk liability in a company as well as give sound reasons for decisions they took including citation of advice taken from internal or external sources. Directors are carefully scrutinized or assessed by either an administrator or a liquidator engaged for this purpose.

**Financial position of a company –Monitoring**

Directors are bound to continually review the company’s financial position in order to determine its solvency and prospects to eliminate involvement liquidation. This can hold if frequent statement of affairs and projections of cash flows with financial information in current formats-together with external advisers and auditors as necessary. The finance director must work within a framework that can keep the board informed about the prospects and performance of the company. This will call for regular board meetings. Relatively, (Webster, 2005 P. 152) stated the following directors duties: “The director should be satisfied that, taking into account their duties to creditors, share holders and employees, the company may properly continue to trade. Each director should carefully consider the company’s ability to pay before arranging for the receipt of any further goods or services on credit, and therefore the board should regularly review the company’s financial position. These reviews should be fully minuted”. In conditions of difficulties, director must verify to see whether the company runs within the “solvency test”. A company is said to be insolvent if it is unable to pay its pending debts or assets valued becomes
lower in value than its liabilities, by considering contingent and prospective liabilities.  

**A company is said to be unable to pay its debts if:**

1. “a creditor owed more than 750 has served a statutory demand at the company’s registered office and the debt has not been paid for three weeks, thereafter;  
2. Execution of a judgment or other court order remains unsatisfied after a visit from a bailiff or sheriff’s officer” (e.g. Webster, 2015)  

Directors must classify a company as a separate legal entity even if it is among a group of companies.

In case of evaluation of finance, this should be done separately to induce clarity and independency in performance or productivity, “this may require a review of facility letters, security, guarantees, joint venture documentation in order to determine the nature and extent of the financial position of each subsidiary” (Webster, 2005 P. 152).

**Seeking Advice**

Directors fall often into unpredicted, impromptu dilemma in diverse ways unless problems are turned around for quicker solutions to safeguard the company. Director must perform in a responsible way, to increase the interest of creditors more than self-will.

In discussions that involve financial position of the company, its importance to involve company’s auditors, bankers and some major creditors as well. “Lawyers will help determine whether a proposed transaction could be vulnerable as a performance or for some other reason, or is otherwise inappropriate. A company might need to retain an insolvency practitioner to advice on the strategies available” (Webster 2005 P. 153). In the development of strategy, the existing advisers should be involved but should be excluded if not qualified in the cases of financial distress.

To strengthen director position and upgrade their competence, access to financial or legal advice including up-to-date, correct and complete information should be sought for. Even if directors have taken the right step and sought advice from well qualified or competent professionals it may happen that, judges may claim they know better. Webster in his commentary stated that, “in some circumstances. There may be a conflict of interest between subsidiary and parent or between fellow subsidiaries, requiring separate legal and/or financial advice; for example, where it is proposed to use the assets of a doubtful solvent subsidiary to secure the parent’s indebtedness” (e.g. Webster, 2005 P. 153).

**Viable strategy formulation**

A board of directors should persistently formulate strategies to restore the good health of a company’s financial position to avoid proceedings of insolvency. It is an action plan which should involve the following:

(a) “alternative trading strategies;
(b) Disposals;
(c) Maximizing existing asset values;
(d) Cutting overheads;
(e) Delaying capital investment;
(f) Further bank finance (possibly with a grant of security);
(g) Converting debt to equity, concerting short-term debt to long-term debt, or raising new equity;
(h) An informal arrangement with major creditors or voluntary arrangement” (Webster, 2005 P. 154). Every strategy chosen should win the full support of the board before it is carried out for implementation alongside its viability reviewed by competent advisers, and implementation monitored constantly. At every board meeting, directors should review a strategy in the initiative of the company’s policies so that they can have the grounds to say that it is a prospect reasonable to escape insolvent liquidation. “They should reconsider the factors that underlay the development of the strategy and confirm whether in their view they are still valid. A board might have committed the company to cutting overheads, delaying capital investment, relocating premises, selling part of the business or procuring fresh equity. At each meeting, the board will need to review whether the strategy is being implemented as envisaged and whether the underlying assumptions (for example, as to the value of properties) are still reasonable” (Webster, 2005 P. 154). Directors should follow realistic valuations; accounting principle and helpful decisions with company’s auditors however, all decisions and advices taken should be recorded in the minutes including underlying reasons.

**Regular meetings**

(Webster, 2005 p. 154/5) stated that: “Board meetings and other, more informal, meetings should be scheduled intervals. All directors should endeavor to be present in person. Detailed minutes should be kept of all meetings and circulated in a timely manner. Additional meetings should be
called as a when new significant event occur. Briefing papers should be circulated before such meetings to promote informed discussion. Absent directors should be told as soon as possible of critical decisions taken at board meetings”. Any personalities responsible for credit control, director of finance, and future financial performance assessor are the major key. Executives of marketing and sales, production are of greater importance to design a recovery strategy as a major input.

**Informing Major creditors**
Information distributed to company’s creditors groups follow an orderly manner. The information’s should be reviewed, discussed with the company advisors and presented with genuine approach. Principal creditors are required to be given information about implementation strategy. Thus lending banks the following clear and careful presentations.

**Financial obligations reviewing**
It is the duty of the board to keep the finance director and the company secretary on their toes, to ensure continual review of:
- Capital maintenance, as imposed by the statute;
- Company’s articles of association restrictions to any kind of borrowing;
- In the company’s loan documentation any financial covenants;
- Any of the regulatory requirements that are seriously affecting the relative action should be taken strictly if there is a chance for any possibility of a breach.

**The making effective announcements**
The financial situation of a company decreases to prompt certain announcements in order to delete the creation of what we call ‘a false market’ with the company’s shares. “Announcing that a dividend might not be paid on a listed preference share, or that a company is in discussion with its bankers, will obviously have a marked effect on creditor confidence. Therefore directors will need to consult their advisors about the timing of announcements” (e.g. Webster, 2005 p. 156).

Directors are subject to criminal offence charges in case they:
1. Make materially misleading, forecast or promise, false or deceptive;
2. Reckless statement, forecast or promise constituting dishonesty or otherwise;
3. Conceal any material facts dishonestly.

Directors will be guilty of the above offences if they deliberately miss-apply their talents to duty.

**Personal liabilities**

**Wrongful trading**
Assuming a company falls into insolvent liquidation, it is likely a director or those in shadow be required to make contribution towards the payment of debts or the liability of the company. (Webster, 2005 p. 156) explained that, “This provision does not merely apply to ‘trading’ activity; any act, or failure to act, that either increases does not minimize losses to creditors can lead to liability” (e.g. Webster, 2005 p. 156). Court determines director’s personal contributions about the level of deflection against company’s assets caused by director’s conduct. A court has the capacity to input contribution order incase a liquidator can demonstrate that “before winding-up began the person know or ought to have concluded that there was no reasonable prospect of the company avoiding insolvent liquidation. The only defense open to a director in these circumstances will be that they took every step they could to minimize the potential loss to a company’s creditors. The ones will be on the director to prove this defense” (e.g. Webster, 2005 the directors handbook, P. 157).

**Organization and solvency strategy**
Change in environment sometimes does not match with organizational strategy, it is clear to pick it as a primary force and stimulator of insolvency and financial difficulties. Organization sometimes should be the cause of the environmental change. (Murray 1984) indicated that; “the chain of causation is not limited to one of environmental change followed by strategy change, followed by structural change. It is equally plausible to suggest the reverse; a change in structure or process may lead to strategy adaption which may result in turn in environmental change”. Due to fluctuations in external and /or internal forces, one can say that, they are also the major determinants of a company’s state of solvency or insolvency despite other odd conditions that may confront directors in their stewardship endeavours. Stewards of a company need to be visionary indeed to run a company within a safer regulatory framework of good policies, techniques including administrative and managing credentials. Valuing all the arms and factors of successful directorship and working with it can instantly change performance and productivity levels of a company positively to benefit the interest of creditors and shareholders. Company directors are advice from within and without to follow or abide by rules and regulations or policies and laws that are designed to guide the performance, viability and growth of a particular industrial firm or company. They must also desist from fraudulent delay or deliberate theft conducts that can limit in a drastically sense, accountable.
annual productivity, prompting the company into collapse and running creditors and shareholders not into magical prosperity but rather into serious risk of financial loss with accelerating bankruptcy. If directors can observe and do their duties very well, lift up the conduct of integrity, remain law abiding and free from stealing, however, work harder for incremental output, then insolvency can be a thing of the past.

**Misfeasance**

“Under the insolvency Act, Office holders and people involved in the promotion, formation or management of a company can be sued for misfeasance-defined by the Act as the misapplication or retention of the company’s assets or a breach of a fiduciary or other duty” (Webster, 2005P160). Actions of misfeasance are formed and leveled in the name of the company. This makes it different from claims stated under wrongfult trading provisions. It is therefore a simpler medium with cruising speed to bring delinquent stewards of a company to book and allocating damages and compensation.

**Trading fraudulently**

“If any company carries on business with the intent to defraud creditors or for any other fraudulent purpose, a liquidator of the company can apply to a court for a contribution order against any person who was knowingly party to the offence: (Webster, 2005P160). They have deliberate intent to do what will harm their neighborhood. These of course remain a risk against directors who turn a blind eye towards a company’s wrongful trade and falling into liabilities, knowing that the deal contains no prospects- than a director can be sued of negligence.

**Disqualification**

The conditions that lead to disqualified or their appointments revoked is well explained by (Webster, 2005, P. 157) that: “The company Directors Disqualification Act 1986 (CDDA) provides that a director can be disqualified for a minimum period of two years for:

1. General misconduct in connection with companies;
2. Conviction for an indictable offence in connection with the promotion, formation, management or liquidation of a company;
3. Fraud in winding-up proceedings;
4. Persistent breaches of companies legislature. An example would be persistent default infilling any return, account or other document with the Registrar of companies;
5. Unfit conduct as the director of a company that has at anytime become insolvent (i.e. gone into liquidation, administration or receivership).

The object of disqualification is twofold: to mark the court’s disapproval and to protect the public. The corollary is that a director can attempt to show that their continued ability to act as a director would carry no risks to the public.

Sometimes, people are allowed to continue to act as directors subject to certain safeguards. There could, for example, be conditions that;

(a) No cheque or financial agreement or behalf of a company is signed or executed by the director alone;
(b) Any loan owed by a company to the director is not repaid unless all creditors of a company are paid first;
(c) The directors are not to be granted or to accept any security over a company’ assets”.

**Conclusion**

Insolvency and financial difficulty strategy is a means through which an enterprise positions it’s self to escape financial distress and business collapse. This concept constitutes a parcel of directives, policies, laws, rules and regulations in brief terms to warrant support or guide technical and managerial credence of directors or whoever may appear willfully or unwillingly to guide the mandate of any business enterprise to avoid condition of bankruptcy.

The emergence of strategic behavior in tilling away from insolvent liabilities and financial hardships is a response to either or both environmental or organizational stimuli. However, directors are to adjust themselves in spite of unfavorable conditions of organizational structures, lack of resources, insufficient or upset motivation and critically dangerous situations that tend to cripple the vision statement of the company.

Directors are to work harder and turn around the inflexible to flexible to win the accord of shareholders and creditors as well as save the company.

**References**


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