

Corporate Rehabilitation: Informal Corporate Rescue Mechanisms for Troubled Companies in the United Kingdom and Malaysia

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ABSTRACT

Corporate insolvency law aims to provide instruments of corporate survival or rescue. The revival of companies on the brink of economic collapse may involve rescue procedures that go beyond the normal managerial responses to corporations in distress and they may operate through both informal mechanisms and formal legal procedures. Most importantly only viable companies and businesses deserve to be rescued. There are various types of rescue actions to turnaround corporate fortunes at a time of corporate crisis. This could be in the form of a broad range of restructuring activities. This article examines the informal rescue practices and mechanisms available to troubled companies in the UK and Malaysia. Some common rescue mechanisms that are discussed include sell-offs, management buy-out (MBO), debt for equity conversion, retrenchment, redundancy as well as ‘workout’ arrangements to restructure debts owed by companies to banks or creditors.

Keywords: Corporate rehabilitation, informal rescue mechanisms, restructuring, turnaround, workout

INTRODUCTION

Corporate rescue has been defined as “a major intervention necessary to avert eventual failure of the company,” (Belcher,

1999) and “the revival of companies on the brink of economic collapse and the salvage of economically viable units to restore production capacity, employment and the continued rewarding of capital and investment” (Omar, 1997). Rescue procedures involve going beyond the normal managerial responses to corporate troubles and they may operate through informal mechanisms as well as formal

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legal processes (Finch, 2009). Central to the notion of rescue is the idea that drastic remedial action is taken at a time of corporate crisis (Belcher, 1997; Finch, 2009). Basically, all these views support the notion that rescues should not be confined to formal rescue procedures but be widened to cover informal rescue mechanisms.

As noted, troubled companies may resort to formal rescue mechanisms. Indeed, there are two types of corporate formal rescue procedures practised in both Malaysia and the UK to resolve a corporate debtor's financial problems namely Scheme of Arrangement (SOA) and Administrative Receivership (AR), while Company Voluntary Arrangement (CVA) and Administration are available only in the UK. Alongside those procedures corporate debtors can be rescued informally. However, when all informal rescue strategies have been exhausted, the ailing company should enter into the formal rescue process as a last resort (Finch, 2002).

It has been pointed out that formal proceedings can be pricey and lengthy, and can destabilise public faith in the company and lay an enormous administrative burden on the debtor (Neyens, 2002). Therefore, companies, when faced with financial problems, may choose to renegotiate their debt directly with their creditors, without recourse to the formal process (Franks and Sussman, 2000). Frank & Sussman (2000) discovered that there are elaborate rescue processes outside formal procedures. They claimed that about 75% of firms emerge from rescue and avoid formal

insolvency procedures altogether (after 7.5 months, on average). These firms are either turned around or repay their debt by finding alternative banking sources. The remaining 25% of cases enter some form of insolvency procedure, usually administrative receivership, or winding up. It is claimed that most rescues are achieved through informal action (Finch, 2009). According to Finch (2009) "informal actions do not demand any resort to statutory insolvency procedures but are contractually based and such actions are usually instituted by directors or creditors and may involve a turnaround professional or 'company doctor' to investigate the company's affairs and to make recommendations."

It should be noted that international bodies such as United Nations Commissions on International Trade Law (UNCITRAL), the World Bank and International Monetary Fund (IMF) have agreed that, besides formal rescue or insolvency procedures to resolve corporate debtors' financial difficulties, there should be informal mechanisms that allow debtors and creditors to resolve their differences in a consensual manner outside the formal procedure (UNCITRAL, 2001; World Bank, 2005; IMF, 1999). In addition, the International Insolvency Institute emphasized that the informal process is significant because formal rescue regimes are not always entirely suitable to the task of rescuing firms with financial problems (International Insolvency Institute, Law & Policy, 2000). Informal attempts at rescuing the company or its business may precede a formal rescue, and may be

done when the fortunes of the corporation could be informally turned around or the ailing company can informally work out the debts owed to their banks or creditors through negotiation or arrangement, without the company entering a formal rescue procedure.

Considering the importance of informal rescue to financially sick firms, this article examines informal rescue mechanisms in the UK and Malaysia. In order to analyse informal rescue actions and activities, the author collected information through primary and secondary data. Sources of data are judicial decisions, textbooks and articles from journals and law reviews. This paper examines the concept of informal turnaround and workout. It also explores some informal common mechanisms as possible components of corporate rescue. These include methods to turnaround the company or its business; to workout with creditors or banks the debts owed by the company to them; and also to negotiate the raising of extra finance or investment in order to rescue the ailing company or its business.

CONCEPT OF INFORMAL 'TURNAROUND' AND 'WORKOUT'

Informal turnaround is a “very general concept and encompasses various types of rescue activities,” (Belcher, 1997) and “such informal turnarounds are often achieved with the support of the company’s bankers and/or of a company doctor” (Walters and Armour, 2006). Meanwhile, informal workouts/arrangements may also cover

possible financing arrangements designed to obtain extra finance in order to stay in business or for the company’s survival.

It should be noted that International bodies like UNCITRAL, the World Bank and the IMF, having discussed the policy choices to be addressed by countries when designing an insolvency system, had focused on arrangement or negotiation as an alternative mechanism to formal procedures, yet gave little consideration to the notion of informal turnaround (UNCITRAL, 2005). Meanwhile, some commentators have defined a turnaround candidate as “a company or business entity faced with a period of crisis sufficiently serious to require a radical improvement in order to remain a significant participant in its major industry” (Zimmerman, 1991; Belcher, 1997).

Belcher (1997) and Zimmerman (1991) view turnaround as a process which involves reversal; meaning dramatic and sustained improvements in the company’s performance at the point of corporate crisis. They also maintain that companies normally revert to turnaround when their very existence is threatened. Other commentators like Goldston (1992) recognise that turnarounds can be classified as a marketing turnaround, financial turnaround or operations turnaround. This means specific types of turnaround may be required for a company depending on the evaluation of the company’s crisis.

A workout is described as financial rescue of a company in distress, which takes place outside the limits of insolvency law (Kent, 1997). According to Belcher a

workout is “the restructuring of the terms of a company’s debt contracts to remedy or avoid default achieved by private negotiations with its creditor outside formal bankruptcy or insolvency proceedings” (Belcher, 1997). It is fair to say that a workout includes arrangements or negotiations between the corporate debtor and its creditor/bankers outside the formal rescue process to obtain financial investments or rescheduling or restructuring of debts. A workout is normally arranged by the company’s leading banks, but it may also involve major shareholders, bondholders, clients and suppliers, who have a direct interest in the continued existence of the company (Kent, 1997).

It seems that the concept of ‘turnaround’ and ‘workout’ involves ‘restructuring’ of the company’s operations, structure, business, workforce or terms of company’s debt as the company responds to the corporate crisis. Also, some measures of rescue attempt or activity are presented to turnaround the company or its business when a workout takes place between the corporate debtor and its creditors or bankers. The following discussion examines the various types of rescue activities to turnaround the company or its business and to workout solutions with the company’s bankers and creditors in order for the company or its business to survive.

COMMON INFORMAL RESCUE MECHANISMS IN THE UK AND MALAYSIA.

As noted, directors, creditors or shareholders are able to take informal and formal actions in order to effect rescues for companies that

are financially distressed (Finch, 2009). It is important to note that various drastic remedial actions may have to be taken at a time of corporate crisis. Rescuing troubled companies may inevitably require the companies to be restructured. Such restructuring involves parts of the business being sold off to other companies or to managers in MBO. The companies may also undergo corporate reorganization or restructuring whereby the workforce is reduced through retrenchment; redundancy or Voluntary Redundancy (VR) or Voluntary Separation Scheme (VSS). The quest to turnaround the company in distress may include refinancing the corporate debts as well as capital reorganization via debt equity swap and to workout with creditors or banks the debts owed by the company to them. In the following sections some informal rescue actions and activities are presented.

Restructuring

It has been pointed out by Belcher (1997) that restructuring is one of the ways used by a company to respond to crisis. Restructuring comes in many forms including sell off, where elements of the business are closed or part of the business is sold to another company or even to managers in a MBO. Restructuring also involves downsizing where the workforce is reduced by means of retrenchment and redundancy, VR or VSS. The company in distress may engage in capital reorganisation by means of a debt-equity swap. It may also need to restructure its debts or financing arrangements and engage in a workout.

Sell-offs and MBO

Selling off parts of the business or closing down parts of the business are the most encountered form of restructuring. When a firm is experiencing financial crisis, closing down a part of the business that is a financial drain can save the rest, and a sell off can have positive effect if it raises much needed cash immediately (Belcher, 1997). Normally, in a sell-off situation, the company must first decide what type of core business it wants to participate in, and then decisions must be made on which part of the business to sell. Here, the core business must be a viable one and the business or assets to sell must be attractive enough to get interested buyers. After selling off the unwanted assets or business, the company resources can be pooled together to concentrate on the core business in order to improve productivity and competitiveness. In return for selling off the non-core business, the company can generate revenue, which can be used to pay off debts and reduce the company's borrowings. With only the core business to concentrate on, company overheads can be reduced to a minimum, and the company can be nurtured back to profitability. As for the non-core business that was sold off, there is a chance that the new owner would be able to rescue it (Belcher, 1997). Therefore, selling portions of the company, such as a division that is no longer rewarding or which has distracted management from its core business, can greatly improve the company's balance sheet.

Sell-offs can also be achieved in the form of hive down, leveraged buy-out and

MBO. In a hive down, the relevant assets are transferred to a newly set up subsidiary company by management for sell-offs. In a leveraged buy-out, the purchase of the business is heavily financed by bank loans (Belcher, 1997). MBO is a special form of sell-off and is defined as a sell-off where the existing management is the purchaser, and this is heavily funded by the bank to enable the purchaser to acquire an existing product line or business (Storey, 1996). According to Belcher (1997) the first stage in a MBO is for the management team to ask the consultant or a financial institution to act as intermediary and carry out an initial appraisal of the proposed deal. If the consultant gives a positive report on the initial appraisal, then informal discussions with the management of the parent company will be initiated (Belcher, 1997). Normally, this will take place before the company is involved in formal rescue. In the UK, if the company is under receivership or administration, a proposal could still be made and this would require less need of secrecy and consultation with intermediaries before the initial approach, as management at this stage would have little to lose. In a case where the initial approach is well received, details of the negotiations will follow. Within a formal rescue regime, the sell-off of part or the entire company becomes public knowledge. However, the negotiation process can be held secret from the public if it occurs outside a legal/formal rescue regime. The management team will need the strong backing of the bank to complete the purchase, and usually this will

work as a filter to discourage incompetent managers becoming purchasers (Belcher, 1997).

MBOs are usually heavily financed by the bank, which normally comes up with ninety percent of the financing with the remaining ten percent being put up by the purchaser. This means that the newly acquired company is quite often left with a high monthly repayment both for the principal amount and the interest in order to service the loan. Despite this, the performance of MBOs is usually very good, with a success rate of more than eighty percent (Belcher, 1997). In an MBO, the success formula is the quality and the innovation of the management team. In numerous circumstances of distress, management is a liability rather than an asset to the company. It is important to note that research comparing results of various studies like Slater (1984) and Belcher (1997) have found lack of financial or accounting control, poor or inadequate management as well as management or marketing problems to be a major contribution to the cause of corporate decline. According to Slater (1984) and Belcher (1997) in many instances, the solution to the problem of company distress is to change the current management so that the company can be turned into a corporate success.

Interestingly, the implications of MBO could be linked to the 'phoenix syndrome' (a shorthand expression), which was identified by the Review Committee on Insolvency and Practice also known as the Cork

Report (1982). The Cork Report referred to the 'phoenix syndrome' scenario where the director of an insolvent company sets up business again and trades with assets purchased at a discount from the liquidator of the old company, leaving behind a trail of unpaid creditors (Cork Report, 1982: Para 1813). Although the report's primary concern was to deal with the director of an insolvent company who starts a fresh company to take over the business of the failed company, it was of the opinion that it is necessary to deal with the director who transfers the trading activities to a new company shortly before in anticipation of the failure of the old (Cork Report, 1982: Para 1830). It should be noted that in the UK part of the regulation of the 'phoenix syndrome' is contained in ss. 216 and 217 of the Insolvency Act 1986.

In Malaysia, rescue may be attempted by selling off or closing down the parts of the business that are caught in financial problems. Restructuring in the form of sell off is also employed to show profit or to curtail deterioration of the company's profit. It was reported that BP plc, Europe's largest oil company, was selling off its petrol stations in 270 outlets in Malaysia for up to RM1 billion, and the decision had been made by BP on the grounds that returns from Malaysia were not good enough (Chia and Shiew, 2004). Similar to the UK, a MBO takes place when the management of a company buys over the company from the existing shareholders and is normally supported by the banking sector for greater

success (Yahya, 1995).

However, MBOs seem to have been a 'mixed bag of results.' Companies like Malaysian Resources Corporation Ltd. (MRCB) and its listed subsidiaries have undergone a MBO in an effort to show profit. Meanwhile companies with managers as owners have also been seen to have better chances for long-term survival (The Edge Daily Business, 2005). It is critical for MBOs to get the support of the banks and the relevant authorities to make it successful. There are two reasons why a MBO may occur, depending on whether the companies are profitable (The Edge Daily Business, 2005). Firstly, in addition to the more common reasons, a MBO rewards managers who have played important roles in running the business. Secondly, an MBO exercise is to allow the managers to freely run and hopefully turn around the business of a company that is not doing well. Notwithstanding that the company was run by the managers, generally the performance of these companies tends to decline or show inconsistent results after a MBO exercise has taken place, as the managers who may be experts at running the company, may not have much experience in making acquisitions. Furthermore, such MBO usually occur within a short time frame and need extensive and multiple sources of capital as well as legal, accounting and other professional support. This could end up being detrimental to the company over the long term (The Edge Daily Business, 2005).

Retrenchment, redundancy, VSS and "Last in, first out" (LIFO) principles

Retrenchment and redundancy are some of the forms of corporate restructuring. "Retrenchment" may happen not only during recession but could also be relevant when the economic situation is good" (Marsono and Jusoff, 2008). Retrenchment refers to activities that reduce the scope or scale of an organization's operations. It has also been referred to as downsizing, resizing, cutbacks and rationalization. If these were necessary for the survival of a company, then it would constitute a rescue (Belcher, 1997). As described by Belcher (1997), the economic arguments for closure of a particular plant or site of operation may be strong and retrenchment may appear to be a relatively easy solution, yet retrenchment may have political costs which should be taken into account. Although retrenchment is needed to help rescue a company or its business, it may not be a popular choice with the workers, managers and the public mainly due to their resistance to change and for economic reasons. A successful retrenchment requires careful management to accommodate the political as well as economic problems and pressure. A high level of morale, motivation, and commitment within the company is also necessary to help make retrenchment a successful turnaround (Belcher, 1997).

In the UK, one example is the case of Ford motor company, which announced on 17 September 2004 that it was closing down the Brown's Lane factory in Coventry and retrenching about one thousand and one

hundred workers. For Ford the justification of the closing down of this plant and the retrenchment was to cut down on Jaguar losses and to cut costs so that the company could be nurtured back to profitability by being more competitive (Pagnamenta, 2004). For the analyst, Jaguar losses could be due to mismanagement, stiff competition, and the weak dollar, which dampened sales in the US market. Jaguar produced 120,000 cars yearly, short of the 300,000 needed to achieve an economy of scales. The production plant closure and retrenchment was supposed to save the company eighty millions pounds yearly. However, this generated a lot of ill feeling amongst the workers toward the parent company, Ford of the US, which promised to keep all three UK production plants afloat since buying it in 1990. The workers in the meantime promised to take whatever action was necessary in order to keep their jobs and this included protests and pickets (Pagnamenta, 2004). In 2007 it was reported that the Jaguar workers' union had given its backing to the Tata Motors' bid to buy Jaguar from the US giant Ford because union members believed its industrial background would be a good fit. Moreover, Tata Motors also promised that it would continue to keep open all three UK factories which jointly employ more than 13,000 workers (Cunliffe, 2007).

According to Honeyball (2006), one of the reasons why redundancy may happen is because a workplace is closing down or fewer employees are needed for a particular kind of work. In the UK, there are statutory controls on redundancy under the ambit

of the Employment Rights Act 1996. This provides that an eligible employee may claim a redundancy payment and such payment is designed to tide an employee over the period of uncertainty and hardship after redundancy (Honeyball, 2006).

It is pointed out that in Malaysia, redundancy and retrenchment are some of the forms of corporate reorganization and it has been referred to as "alteration in the structure of the company or business ... for the primary purpose of sustaining the continuity of the company or the business itself on a going-concern basis" (Segaran, 2000). Redundancy as pointed out by Segaran (2000) occurs where the company concerned is faced with redundant employees due to either a surplus of labour or the reduction of workload for specific positions after the reorganization, and under such circumstances, the retention of the services of the redundant employees would not be economically sound for the company if it were to continue to exist as a profitable ongoing concern. It is likely in this situation that redundancy will be considered as one of the rescue mechanisms where companies will try to cut costs by reducing their workforce in order to stay in business or for the survival of the company.

According to Marsono and Jusoff (2008) redundancy can occur for a number of reasons such as a downturn in production, sales or economy; the introduction of technology; business relocation; a business merger or a business is sold; or restructuring of a company. It is claimed that the law permits termination of service for operational

reasons under the umbrella of redundancy (Marsono and Jusoff, 2008).

In the case of *Bal Plantations Sdn Bhd v. Sabah Plantation Industry Employees' Union* (1984) the court held that the term 'retrenchment' connotes, by its ordinary acceptance, that the business itself is being continued but that a portion of the labour force is discharged as surplus. In another case *Georgetown Pharmacy (M) Sdn Bhd v. National Union of Commercial Workers* (1992) the Industrial Court confined the usage of the term 'retrenchment' to mean a discharge of surplus labour. Accordingly, retrenchment means the termination of a contract of service for reasons of redundancy.

Interestingly, it is well established in Malaysia's Industrial Law that if an employer is a company, it has the right to restructure its business in such a manner, as it believes fit for economic efficiency. In this respect, the company may downsize its workforce by means of redundancy and retrenchment (Segaran, 2000). This principle was upheld in *Maser Sdn Bhd v. Yeoh Oon Wah* (1990) where it was decided that it is for the management to decide the strength of its staff which it thinks necessary for efficiency in its undertaking and the court cannot dictate to the employer the number of persons to be employed in order to run its business profitably. Furthermore, it was held in Maser's case (1990) that the employer has the right to restructure the enterprise and to terminate the service of employees who are redundant. An employer who carries out a retrenchment exercise must be motivated by sound reasons and conviction that such an

exercise is indeed desirable and that it will enable the employer to run the business more efficiently in the long term.

In a case of *Plusnet Communication Sdn Bhd & Ors v Leong Lai Peng* (2005) the court was of the opinion that a redundancy situation did exist as a result of reorganization and downsizing carried out by the company to minimize losses. It has been pointed out by Marsono and Jusoff (2008) that the court will look at several matters when the issue of retrenchment is referred to them. Amongst others these include whether retrenchment was justified; whether the employer is in a position to give the true grounds for the retrenchment and whether the retrenchment is made *bonafide*. The court in *TWI Training and Certification (SE Asia) Sdn Bhd v Jose Sebastian* (1998) has ruled that as long as the measures taken by the employer are genuine commercial and economic considerations, it has the managerial prerogative to decide in the best interest of its management to identify its own area of weakness and then proceed to discharge its own surplus. It has been emphasized that retrenchment must be a *bona fide* exercise and the employer should not abuse such prerogative (Segaran, 2000). It has been decided in *Kumpulan Perubatan (Johor) Sdn Bhd v Mohd Razi Haron* (2000), that massive retrenchment made by the employer was a genuine measure and not done for any ulterior motive to victimize the employees. The Industrial Court also found no evidence that the employer had acted with *mala fide* in the retrenchment process.

In *Gurbux Singh Prabha Singh v. J White & Co (M) Sdn Bhd* (1981) it was held

that the employer should, when selecting employees to be retrenched, not only act reasonably, but also observe any customary arrangement or code of conduct. The code of conduct referred to in this case is the Code of Conduct for Industrial Harmony 1975 (Code 1975). This code was endorsed in February 1975 by the Malayan Council for Employer Organisations (representing employers) and the Malaysian Trades Union Congress (representing employees) and was witnessed by the Minister of Human Resources. The purpose of the Code is to promote sound industrial relations practice in Malaysia and to lay down principles and guidelines to employers and employees on the practice of industrial relations for achieving greater industrial harmony (Segaran, 2000). Section 30(5A) of the Industrial Relations Act 1967 provides :

“In making an award, the Court may take into consideration any agreement or code relating to employment practices between organizations representative of employers and workmen respectively where such agreement or code has been approved by the Minister.”

In *Kesatuan Pekerja-Pekerja Perusahaan Logam v. KL George Kent (M) Bhd* (1991), the Malaysian High Court upheld that the Industrial Court is bound to consider the provisions of the Code of Conduct for Industrial Harmony while deciding on disputes relating to

retrenchment. In this case, there was a provision in a collective agreement between the employer and employees that they agreed to observe the provisions of the Code. One of the provisions in the Code provides that the retrenched employees should be given priority for engagement or re-engagement. However, the Industrial Court in its decision did not consider this provision. On appeal the High Court reversed the Industrial Court’s decision and held that the latter has made a jurisdictional error when it failed to consider the relevant clause in the collective agreement. The employer was bound to follow the provision of the Code, which provided that the retrenched employees should be given priority of engagement or re-engagement rather than bringing in new employees.

It is important to note that the Industrial Court recognized the principles of Code 1975 and this has generally been accepted as good industrial relations practice in undertaking a retrenchment exercise (Segaran, 2000). In *Rocon Equipment Sdn Bhd & Anor v Zainuddin Muhammad Salleh* (2005), the Industrial Court stressed that although there is ample justification for redundancy, the retrenchment is to be done in line with the accepted standards of retrenchment’s procedure. Code 1975 suggests that one of the appropriate measures to be taken by an employer under retrenchment is to introduce VSS before imposing the redundancy and preferably for such Scheme to be combined with reasonable monetary benefits (Clause 22 (a) Code of Conduct 1975). It should also be noted that in the Malaysian context,

companies could employ VSS as one of the avenues to reduce costs in the long run. Employers are told to give as early a warning as practicable and consult the employees and their union representatives. The employer must also spread the retrenchment over a longer period and also retire workers who are beyond their normal retiring age (Clause 22(a) Code of Conduct, 1975). Furthermore, with effect from 1998, all employers are required by virtue of s. 63 A of the Employment Act 1955 to submit a report on retrenchment to the nearest Labour Department of the impending retrenchment exercise at least one month before each retrenchment is carried out.

The principle of “Last in, first out” (*LIFO*) or “first come, last go” or “last come, first go” is recognized and applied by the Malaysian Courts (Ahmad Mir and Ahmad Kamar, 2003). *LIFO* means the junior employee would have to leave employment before the senior could be directed to leave (Ramasamy, 2002). According to Marsono and Jusoff (2008) such an arrangement has advantages to employees as it reduces the possibility that the management may make selections in terminating employees on the basis of favouritism. In the case of *Aluminium Company of Malaysia Bhd v Jaspal Singh* (1978), the employee was retrenched by the company on the grounds of redundancy, which was challenged on the ground that there was no such redundancy. In this case the Industrial Court ruled that the principles of *LIFO* have to be followed by the employer in the case of retrenchment. The Court found that the claimant’s job

was still in existence after his retrenchment and the employer had failed to consider that the claimant was the first who joined the company for the post compared to the other superintendents. As a result, the court held that the retrenchment was wrongly exercised. The Court also said that the question of comparative seniority of an employee for applying the principle of *LIFO* has to be determined with reference to the employee working in the same category. It is important to note that the principle of *LIFO* is only applied where other things are equal (Ahmad Mir and Ahmad Kamal, 2012). Ahmad Mir and Ahmad Kamal (2003) have pointed out that the principle of *LIFO* restricts employer’s common law right to decide which of the employees should be retrenched. Indeed, the employer can *bona fide* retain employees possessing special qualification in the interest of the business without following the principle of *LIFO*. However, the reason for departing from the rule must be stated in the order of termination (Ahmad Mir and Ahmad Kamal, 2003).

Marsono and Jusoff (2008) argued that the principle of *LIFO* is flexible and the Code is merely a moral guideline between the employer and employees and no penalty can be imposed against the employers for their failure to follow its provisions. Nevertheless, in the case of *Mamut Copper Mining Bhd v Chau Fook Kong & Others* (1997) and in *Weeluk Cooperation (Sarawak) Sdn Bhd v Wee Siak Luan* (1998) the courts emphasized in *Mamut’s* case that the employers are

expected not only to follow the *LIFO* principle but also other principles provided for by the Code. However, in the latter case the court held that a retrenchment is only justified if it is made in line with the accepted industrial relations standards, practices and procedures.

Accordingly, for the survival of the company or its business, a company has the right to downsize its workforce via redundancy or retrenchment, yet it must comply with the Code and *LIFO* before opting for a retrenchment exercise. It is fair to say that it has always been the company's prerogative to reorganize its business for the sake of the company or business survival. The courts will always respect the company's decision as they are not 'men of business'. Indeed the courts acknowledged the importance of making commercial decisions on the part of the company as an employer. Furthermore, the company as an employer has the prerogative power especially in matters relating to an improvement of its business (Marsono and Jusoff, 2008). However in doing so, the company must follow the law. Despite the prerogative power to organize and arrange its businesses including determining whether or not to retrench the employees, the company's purpose of carrying out a retrenchment exercise must be for genuine reasons as well as be free from *mala fide* or unfair labour practices. If there is no ample justification for redundancy, it shall be deemed that the termination was without just cause or excuse as decided by Federal Court in the case of *Goon Kwee Phoy v J*

& P Coats (M) Bhd (1981). Accordingly, in case of a breach of an employment contract or unfair dismissal by a company or an employer, legal action could be brought against them.

Debt for Equity Conversion/Swap

Another form of rescue activity available to ailing companies in the UK and Malaysia that may informally turn the company affairs around is debt-equity conversions. This can be defined as 'capital reorganizations in which creditors (usually, but not exclusively, lenders) exchange or convert a proportion of a company's indebtedness for one or more classes of its share capital' (Chatterji and Hedges, 2001: p.246). It is claimed that debt-equity transactions can provide an effective and efficient means of allowing troubled companies to continue operations and of avoiding formal insolvency procedures (Finch, 2009). Such transactions might be attractive for the creditors as well as companies. For companies these transactions may reduce their financial risk by improving their balance sheet structure whilst relieving cash flow and working capital difficulties. When a company plans for equity swap transaction, it is usually in a state where it is unable to meet its debt servicing burden and its business operations are seriously constrained, either by lack of operating or investment cash. Therefore, by substantially reducing its debt-servicing obligation a swap transaction provides a robust financial foundation for its turnaround (Chatterji and Hedges, 2001).

Debt-Equity conversion can also bring back strategic shareholders confidence in the company since debt swap transaction increases the company's financial strength (Finch, 2009). Through the transaction, the financial profile and gearing of the company will improve as debts and competitive disadvantages are eliminated. Consequently, the company has a brighter opportunity to get new credit line from creditors, to attract new business as well as to restore the confidence of its current customers. From the creditor's point of view, a debt/equity conversion is attractive because it would give them a chance to earn a higher return on their investment than the return available on liquidation (Finch, 2009). This is especially true in a situation where banks have given loans without collateral to larger quoted groups that have borrowed from many banks. The rate of recovery is very low in an insolvency process and as such debt/equity conversion can be more desirable than resorting to a formal insolvency procedure (Finch, 2009). In a prestigious project, a debt to equity conversion is a good public relations exercise for the creditors' companies because the public will see the creditors as being dedicated to the industry and devoted to its customers during their financial dilemma (Finch, 2009). In 1996 in the UK, the Department of Trade and Industry stressed the important contribution that debt/equity swap can make in allowing troubled companies to reorganise their affairs (DTI, 1996; Finch, 2009).

Apart from all the advantages mentioned, debt to equity conversion also faces a few

difficulties and drawbacks. Finch (2009) emphasises that in debt to equity conversion schemes, creditors will lose their priority (unless they are secured or preferential creditors) if the company was to liquidate due to their new status as shareholders, and they will only receive their payment after all the creditors have been paid. Another drawback of this scheme is that they tend to be considerably more complicated than conventional debt refinancing and rescheduling and involve many parties with conflicting interests and complex legal and regulatory issues which make it time consuming and expensive to complete a successful scheme (Chatterji and Hedges, 2001). In addition, extra shareholders bring considerable on-going legal and regulatory commitment, and banks do not normally have the administrative infrastructure to deal with shareholdings even though some of the commitment can be assigned to a lead or agent bank (Chatterji and Hedges, 2001). The Banks' situation as lender and shareholder can result in possible conflicts of interest, as there can be pressure to continue giving money to a company in which an institution is a shareholder, even though such lending does not meet the minimum credit requirement (Chatterji and Hedges, 2001).

Rescheduling and Extra Finance or Fund

Companies in distress can negotiate to restructure the terms of a company's debt and such agreement may operate informally and contractually (as well as within a formal process by means of SOA practised in

both UK and Malaysia; or CVA between the corporate debtor and its creditors or bankers which is practiced only in the UK). Rescheduling is “a contractual arrangement entered into by a debtor company or companies with all or some of their banks or creditors” (Lickorish, 1990: 53). Debt rescheduling permits the company to stay alive for the time being by reducing its debt servicing obligations in terms of reduced capital repayments and /or interest charges, besides which there is no direct injection of finance (Belcher, 1997).

Rescheduling the company’s debt may ease immediate problems faced by a troubled company, in particular where the company’s credit is supplied by a small number of banks and the company’s financial problems are short term in nature (Finch, 2009). Finch (2002) argued that rescheduling may catch the attention of the banks since such informality evades the adverse publicity involved in precipitating the liquidation of a company. According to her, rescheduling allows securities to be adjusted and may be appropriate where a few banks are involved, and the company’s financial problems can be overcome by changing the progressive interest or principal repayment (Finch, 2002). In addition, where creditors in a diversity of jurisdictions are involved with a company, it may be faster and cheaper to react to problems by negotiating new contracts rather than by resorting to formal proceedings (Finch, 2002). One of the main problems of rescheduling is that when many banks are involved and some banks feel uncommitted to the company involved, there is a lack of close relationship with the

company, and thus an absence of loyalty to the company (Finch, 2002).

When companies are faced with financial crisis, they can resort to their banks or other banks to provide additional finance if their individual managements are capable, and have a core business that is viable with good planning. These factors may give confidence to the banks to lend the company extra finance. It is fair to say that by offering extra finance at times of crisis the banks can and do rescue small companies. This is also referred to as ‘bank rescues’ (Belcher, 1997). Perhaps such ‘bank rescues’ are more straightforward in a case where the banks are already the lenders to the company and should know the company better to make a good evaluation of the company’s survival before getting involved with arrangements for any additional finance to the company. With faster reimbursement of the additional finance a company can react at an early stage to help solve its financial difficulty. For most companies such a problem may only be short term in nature, thus, quick additional financial help from the banks is enough. Apart from bank rescue another alternative available to a company facing financial crisis is to initiate formal rescue procedures. However, the bank, as a secured lender also has an option to initiate action for repayment of the facility or to put the company under liquidation process or appoint a receiver or an administrator (only applies in the UK). In this situation, the company is at the mercy of the banks.

In Malaysia, workouts or financing arrangements cover extra finance from banks and rescheduling which is similar to

practice in the UK.. Practically companies which are facing financial distress in Malaysia can negotiate with their bankers/creditors to reschedule their borrowing. Normally, if they have a viable proposal the banks/creditors would agree to reschedule their borrowing. This can be done by reducing their monthly repayments and thus prolonging the repayment period. Indeed, the central bank of Malaysia, Bank Negara, encourages banks to work closely with their clients (Central Bank of Malaysia, 1999). It is possible for companies facing financial difficulties to request that their bank give extra finance or funds to help them alleviate the problem (Central Bank of Malaysia, 1999). Again, the banks would normally look at the viability of the business in which the companies are engaged, and if the businesses were viable, this would improve the chances of the companies getting additional finance from the respective bank (Central Bank of Malaysia, 1999).

Informal workout: London Approach (LA) and Corporate Debt Restructuring Committee (CDRC)

The concept of informal workouts in the UK includes the 'London Approach' (LA) of which the Bank of England (BOE) is the patron. This approach has been copied and developed in some other countries including Malaysia; yet such an approach needs to be tailored to fit local circumstances. In Malaysia the establishment of the CDRC in 1998 with guidance and headship from the CBOM was inspired by the BOE supervision in the corporate workout

(Azmi and Abd Razak, 2011). The lack of an orderly arbitration to workout debtor-creditor problems without resorting to legal proceedings in rescuing financially troubled companies in both jurisdictions, was the main reason why the central banks in both countries published a set of non-binding guidelines via the LA and the CDRC. Accordingly, both the LA and CDRC provide incentives for corporate borrowers and their creditors/banks to negotiate a corporate workout outside the confines of the formal rescue process. The LA under the patronage of the BOE came into force in the UK thirty five years prior to the creation of the CDRC in Malaysia and indeed was the inspiring scheme behind the creation of the latter.

As noted, the CDRC's framework was a reproduction of the LA that has been tailored to fit into the specific conditions in Malaysia with some modification. The key features and framework of both mechanisms are similar. For instance, banks/creditors are supportive and sharing of information among the participants in the workout and losses are carried out in a fair manner (Kent, 1996; Rajandram, 1999). Indeed, their frameworks are comparable including a 'standstill'/moratorium' period among the creditors towards the debtors company where no enforcement actions are taken against the latter, as well as an investigation of the company's financial standing to determine the viability of the company's business. Such moratorium is informal rather than formal like the one available under formal rescue procedures within the

SOA (only Malaysia has a moratorium in its Scheme), administration and CVA with moratorium (applicable only for the UK). However, both informal and formal moratorium come within the collective rescue regime that holds back individual debt enforcement among creditors enabling it to prevent the damaging 'race to collect' among creditors that results in the gradual 'take to pieces' of the corporate assets.

Ironically, one of the weaknesses of the LA and CDRC lies with the informal moratorium, while another disadvantage of both workout frameworks is the need for unanimity of support from relevant creditors; if a single creditor refuses to agree to a proposed negotiation, this could result in a failed workout. Moreover a requirement for unanimity risks slowing down the workout process, and therefore they may be practicable when the creditors consist of a small group of banks rather than when large groups of banks and non-banks are involved. In the UK, the BOE in the past has suggested the possibility of majority voting as a solution for the need of unanimity, and unless such recommendation is implemented, it will remain the main disadvantage of a corporate workout. Nonetheless, such workout has the inherent fragility of being dependent upon a high degree of co-operation amongst a different range of parties, and it may be no exaggeration to say that the failure of such co-operation may result in the initiation of the liquidation process, which in many cases will lead to the downfall or demise of the company (Brown, 1996; Bird, 1996).

Under the frameworks of the LA and CDRC, if the company or its business is viable the banks may consider providing financial support for the troubled company that includes, amongst others, further lending of new money, which may help to overcome their financial problem. Yet such additional cash flow is normally given priority (by agreement) as the price for the former consent as well as reflecting the additional risk accruing to them, and this appears to portray that the banks/secured creditors fare better at the expense of other creditors as well as shareholders (Buljevich, 2005; Koh, 2003).

The differences between the LA and CDRC are illustrated in their choice of adviser; the LA, being more specific, will appoint a team of accountants to investigate the company's finances, whereas under the CDRC, such a similar task would be conducted by an independent financial advisor (consultant), which might include an accountant. Moreover, unlike the LA, the viability of the business was not the only criterion for a company to be eligible under the CDRC; the debtors should have had borrowings from at least two creditors amounting to a minimum aggregate borrowing of RM30 million. The LA can employ any suitable method for restructuring depending on circumstances, as it is up to those involved to agree whereas the restructuring method under the CDRC as reported included debt to equity conversion, debts/interest waiver, cash payment, debt rescheduling, redeemable instruments, convertible redeemable instruments and

convertible irredeemable instrument (Rajandram, 1999; CBOM, 2007). Similar to the role of the BOE under the LA, wherein the central bank acts as a peacemaker, the CBOM worked closely with the CDRC on the basis of the mediation concept in order to facilitate and steer negotiations between banks and corporate debtors. If the BOE plays the leading role of the mediator in the corporate workout based on the LA's structure, the same role was played by the CBOM through the Steering Committee (SC) headed by the Governor of the CBOM (Azmi and Abd Razak, 2011).

It is important to note that there are some problems as well as challenges for a non-statutory corporate workout under the framework of the LA and CDRC, like the issue of 'new money,' debt trading or credit derivative, (even though such issues probably arose with less attention within the CDRC). The arrangement via LA and CDRC is informal, has no binding legal status and can be called off by either party at any time. Notwithstanding that, the arrangement offers flexibility where no changes in power are required but the company may get a fresh injection of funds while creditors may strengthen their positions. Even though, CDRC announced its closure in 2002, it was restored in July 2009. CDRC was revived as part of pre-emptive measures against any large increase in nonperforming loans in the Malaysian banking system during the current global recession (Azmi and Abd Razak, 2011). CDRC remains as an informal corporate rescue workout even after it was revived in 2009. However, CDRC

is not for every company with financial difficulties. The applicant company, as part of the requirements, must have a potentially viable business and only those company that have aggregate indebtedness of RM30 million or more with at least two financial creditors are covered under CDRC (Azmi and Abd Razak, 2011).

CONCLUSION

A company can be rehabilitated without resort to the formal insolvency system if its financial distress is detected earlier and it can be resolved quickly through an informal rescue that offers many advantages to both creditors and debtors. What is important is for the company to have a viable business and the turnaround professional or 'company doctor' who can advise on the best alternative to take in order to rescue the company earlier, thereby increasing the chances of success. Informal rescue processes generally involve voluntary negotiations between the debtor and some or all of its creditors. Often these types of negotiations are developed through the banking and commercial sectors and typically provide for some form of restructuring of the companies in distress. Informal rescue offers a number of potential gains as it is faster and cheaper than formal rescue and offers a lot of confidentiality, thus protecting the goodwill and standing of the company. There is always flexibility in the informal rescue negotiation, where the terms and conditions of the rescue can be changed during negotiation, while formal rescue process would not have the same degree of flexibility. Despite all the

good points that informal rescue offers, it also suffers from weaknesses. The first weakness is the requirement of unanimity (like in the case of workout/arrangement with the lenders) where the agreement of all parties whose privileges are affected will generally be required if the rescue is to succeed. The second weakness is that there is lack of formal moratorium. Therefore, creditors who oppose the process have the right to disrupt the informal rescues by initiating formal insolvency procedures, including liquidation. This risk therefore makes an informal rescue a fragile device dependent on the cooperation of all parties. Nevertheless, it can be seen that there are always material advantages for both creditors and debtors in the speedy completion of informal rescue.

The above discussion on informal corporate rehabilitation reveals that there is a broad range of rescue activities or mechanism available to ailing companies and creditors to figure out if the company or its business is viable and deserves to be rescued. It can be seen that ailing companies may be “reorganised (where, for example, managerial reforms are instituted), restructured (where, perhaps, closures of elements of the business are involved), refinanced (as where new capital is injected or debts are rescheduled), downsized (where operations may be cut-back, workforces reduced or activities rationalised) or subjected to sell-offs (where parts of the business are sold to other firms or even to managers in management buyouts” (Finch, 2009; p.244). The discussion on

types of rescues activities is definitely not comprehensive. However, rescue measures like sell-offs, MBO, retrenchments and debt equity conversion are some of the common rescue measures that are available in both Malaysia and the United Kingdom.

Such rescue measures could all occur outside formal rescue regimes and for some troubled companies this could be part of a formal proposal within a formal rescue procedure. For instance, a MBO can take place under receivership or debt for equity conversion within a SOA or CVA (only in UK). Meanwhile in large-scale informal workout or arrangements for companies with banks or creditors, unless unanimity of support of the affected creditors is obtained, the workout would fail. Arguably, the participants have the option to organise the workout within a formal rescue regime like the SOA that can proceed with majority voting and without unanimity, but binds both dissenters and the apathetic. Formal and informal rescue procedures are related, partly because formal rescue procedures provide the baseline for negotiations among stakeholders seeking to achieve an informal rescue (Walter and Armour, 2006). In this sense, in the UK context it is claimed that the Enterprise Act 2002 affects the terms on which the various interested parties bargain in the shadow of the law and may therefore influence their behaviour prior to the commencement of a formal rescue procedure (Walter and Armour, 2006). While in Malaysia, it is pointed out that the informal rescue or workout co-exists with formal rescue proceedings and for informal

workouts to be effective, there must be mechanisms in place within the existing legal infrastructure to transform the informal agreements into legally effective solutions (Kit Lee, 2001). Meanwhile, international organisations like World Bank recognise that informal workouts are negotiated in the 'shadow of the law' and an environment that includes clear laws and procedures is necessary to encourage participants to restore an enterprise to financial stability (World Bank, 2005). Formal rescue procedures do indeed form the backdrop to these workouts/arrangements and if informal rescue (turnaround or workouts) fails, the company goes into formal rescue procedures.

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