

## ENTERPRISE BANKRUPTCY INSTITUTIONS OF LITHUANIA AND KYRGYZ REPUBLIC: COMPARATIVE ANALYSIS

*Көз каранды эместикти алгандан кийин, Литвада жана Кыргызстанда да экономикалык тутумдун жаңыдан иштөө жана анын базар экономика болуу зарылдык болгон. Бул этапта экономикага өндүрүштүн төмөндөшү, экономикалык кризис, инвестициялардын жоктугу жана акча-кредиттик мамилелердин катаалданышы сыяктуу көрүнүштөр мүнөздүү. Бул шарттарда төлөөгө кудуретсиз (банкрот) ишканалар пайда болушу сөзсүз. Ушуга байланыштуу банкрот институтун түзүү жана өнүктүрүү зарылдыгы туулду. Банкрот институту закондук акттардын жазууменен гана чектелбестен, төлөөгө кудуретсиз ишканалар менен иштеген мамлекеттик органдарлы да камтыйт. Төлөөгө кудуретсиз ишканаларды башкаруу маселесинде Кыргызстан менен салыштарганда Литва алдыда. Ошондуктан Кыргызстан Литванын тажрыйбасын алып жана банкрот институтунун ишин жакшыртса болот.*

*После приобретения независимости, как и в Литве, так и в Кыргызской Республике необходимо было реструктуризировать всю экономическую систему страны и переориентировать ее на рыночные отношения. На данном этапе экономике присущи такие явления как спад промышленности, экономический кризис, отсутствие инвестиций и ужесточение денежно-кредитных отношений. В этих условиях появление неплатежеспособных предприятий (банкротов) неизбежно. В связи с чем возникает необходимость в создании и развитии института банкротства. Институт банкротства, в свою очередь, предусматривает не только написание законодательных актов, но и соответствующих государственных органов по работе с предприятиями-банкротами. В вопросе управления неплатежеспособными предприятиями Литва преуспела больше, чем Кыргызская Республика, что доказывается статистическими данными. Поэтому Кыргызстан может позаимствовать опыт Литвы и улучшить работу института банкротства.*

*After becoming independent, it was necessary to restructure the complete economic system of the country and reorient it to the market relations both in Lithuania and in Kyrgyz Republic. At this stage, such phenomena as setback in industry, economic crisis, and absence of investments and stiffening of money-and-credit relations are inherent to the economy. Under the circumstances, appearing of enterprises in default (bankrupt) is inevitable. Due to it, it becomes necessary to establish and develop bankruptcy institution. In its turn bankruptcy institution provides not only for writing of legislative acts, but also for involving of relevant government authorities working with bankrupt enterprises. As for the matter of controlling bankrupt enterprises, Lithuania succeeded more than Kyrgyz Republic, which is proved by the statistic data. Therefore, Kyrgyzstan may adopt the experience of Lithuania and improve operation of the bankruptcy institution.*

### **1. Introduction**

Bankruptcy institution is the most important element of the market economy mechanism. It destined for voluntary and compulsory liquidation of insolvent legal entities, individual entrepreneurs, when their measures on prevention of bankruptcy, execution of pre-judicial restructuring or supervision, or external management failed to ensure necessary level of organization's solvency. Besides it, the bankruptcy institution serves as the powerful stimulus for

effective work of business organizations, by simultaneous guaranteeing economic interests of creditors as well as of the government as general market regulator.

Bankruptcy institution has recently started to work in Lithuania and Kyrgyz Republic (only since independence). Therefore, there are shortcomings in this sphere, which should be eliminated with the development of country's economy. Nevertheless, the bankruptcy institute of Lithuania is more improved than of Kyrgyz Republic and advantages of the Lithuanian experience can be introduced into the work of Kyrgyzstan bankruptcy institution.

The last years Lithuanian scientists pay big attention to researches in bankruptcy field. Especially a lot of researches in prediction of bankruptcy in the enterprises and in the commercial banks (Virbikaitė and Beržinskienė, 2006; Stundžienė and Boguslauskas, 2006; Garškaitė, 2008; Podvieszko and Ginevičius, 2010; Ginevičius and Podvieszko, 2011; Brauers et al., 2012 and others). But Kyrgyz Republic has not researches in bankruptcy field.

The present research work analyses bankruptcy institutions of Lithuania and Kyrgyz Republic and carries out comparative analysis of statistical data of these two countries. Besides it, the work states advantages of the Lithuania's bankruptcy institution, which might be applied in Kyrgyz Republic.

Aim of research – to analyze Lithuania's bankruptcy institution in order to apply experience of this country in improving of the work of Kyrgyz Republic's bankruptcy institute.

Object of research – bankruptcy institution of Lithuania and Kyrgyz Republic.

## **2. Bankruptcy institution of Lithuania**

The Republic of Lithuania law on corporate bankruptcy has within a relatively short period of time “survived” as many as three main editions and amendments (Garškienė and Garškaitė, 2003). In 1992, the Supreme Council of the Republic of Lithuania passed the first bankruptcy law - the 15 September 1992 Law of the Republic of Lithuania on Enterprise Bankruptcy. The law was replaced by Law of the Republic of Lithuania on Enterprise Bankruptcy which was enacted by the Seimas on 17 June 1997. The latter, after several revisions as well as some inconsistencies with the practice of Lithuanian courts, was replaced by a completely new 20 March 2001 Law of the Republic of Lithuania on Enterprise Bankruptcy which came into force on 1 July 2001 along with the set of other new corporate laws (Doing business in Lithuania).

### **2.1. Bankruptcy process**

Under Article 2 of the Enterprise Bankruptcy Law of the Republic of Lithuania bankruptcy proceedings means a civil case opened in court over disputes arising from legal relations connected with bankruptcy.

The purpose of *bankruptcy* proceedings is: to ensure a uniform treatment of requirements of creditors and satisfy requirements of creditors after having realized a debtor's assets in the order established by laws.

The aim of the *restructuring* procedure is: to capacitate enterprises that have temporary financial embarrassments and that have not seized their economic – commercial activity to maintain, develop the activity, repay obligations, renew solvency and avoid bankruptcy.

Under effectual laws, *restructuring*, as insolvency proceeding, may only be formal. *Bankruptcy* proceedings can be both formal and informal. Bankruptcy proceedings may be enacted not following judicial order if there are no cases in court wherein there are material claims including claims regarding labor relations, also if an enterprise is not being levied under enforceable instruments issued by courts or other institutions.

There are two equivalents of formal insolvency proceedings for administration purposes in Lithuania – restructuring and making a composition with creditors in bankruptcy proceedings. Composition with creditors means an agreement between the creditors and the enterprise to continue the activities of the enterprise where the latter assumes certain liabilities, whereas the

creditors agree to defer the satisfaction of financial claims or to reduce the amount thereof or to waive their claims (Bankruptcy – Lithuania).

Formal insolvency proceeding for liquidation purposes is declaration of bankruptcy of an enterprise and its liquidation.

It should be noted here that the bankrupt enterprises are subjected to all bankruptcy proceedings in Lithuania. Even if the percentage ratio of proceedings to be applied to recover the business is not so big as application of special administration procedures such as liquidation, relevant government authorities treating enterprises in default still try to recover the enterprise's activities in the first place.

## **2.2. Bankruptcy policy in Lithuania**

Institutions involved into bankruptcy process are : Department of Enterprise Bankruptcy Management under the Ministry of Economy, National Association of Business Administrators, National Association of Bankruptcy Administrators, The State Social Insurance Fund Board, State Tax Inspectorate.

The Ministry of Economy is responsible for the the implementation of the Programme for Enterprise Restructuring and Bankruptcy aiming to reduce the number of companies in temporary financial difficulties and still continuing their business activities, and to speed up the bankruptcy processes of insolvent enterprises.

Key tasks of the Department of Enterprise Bankruptcy Management under the Ministry of Economy (hereinafter referred to as DEBM) include implementation of the Government policy in the activity, restructuring and bankruptcy areas of loss-making enterprises, activity analysis of enterprises undergoing the processes of restructuring and bankruptcy as well as bankrupt enterprises. Furthermore, DEBM implements supervision and control of the aforementioned enterprises within the powers granted by the Government and/or the Ministry of Economy.

Within the process of problem analyses and decision-making DEBM follows the principle of improving business conditions thus pursuing the following targets: to make the conditions for ineffectively operating economic entities as well as those willing to terminate their operation to withdraw from the market; and to restructure the viable economic entities by the process of decentralisation and commercialisation.

The Bankruptcy Management Department of the Ministry of Economy, the primary regulator for administrators, lacks capacity to effectively implement and monitor the system. The Bankruptcy Management Department is responsible to ensure that administrators comply with the requirements of relevant laws and court decisions, and execute resolutions of the meetings of creditors and creditors' committees. The Department lacks the necessary staffing to carry out this supervisory function on a large scale and systematic basis; rather, it responds to complaints lodged with it by participants in the proceedings. Another responsibility of the Department is to establish the licensing standards and criteria and to administer professional examinations for prospective administrators.

Restructuring administrators are responsible for supervising the debtor enterprise during the period when the restructuring plan is being prepared, and in law are accountable to the enterprise or the creditors for any damage their actions cause. However, the concept of damage by such a professional is not well-developed in Lithuania, and the administrators are not required to either post bonds or, unlike accounting professionals, carry professional liability insurance. Judges complain that administrators lack the requisite knowledge of the law, forcing judges to handle routine tasks administrators. Results have been more positive where the administrator is a legal entity that engages a number of different professionals (including some lawyers). Even among legal entities, however, the level of skills and services provided is inconsistent (Bivainis and Garškaitė, 2006)

## **3. Bankruptcy institution of Kyrgyz Republic**

Law of the Kyrgyz Republic "On bankruptcy (insolvency)" was adopted two years later than in Lithuania. First wording of the Law was put in force in January 15, 1994. The second and currently acting wording of Law of the Kyrgyz Republic "On bankruptcy (insolvency)" was put

in force in October 15, 1997. Since that time, six amendments and additions have been introduced thereto within ten years. Five of them have been introduced: December 30, 1998; July 7, 1999; September 29, 2000; June 17, 2002; March 7, 2005. Latest amendments and additions of Law of the Kyrgyz Republic “On bankruptcy (insolvency)” were introduced in January 27, 2006 and are deemed to be latest.

### **3.1. Bankruptcy process**

Bankruptcy process is activities of authorized government bodies, courts, administrators and creditors controlled by the laws, which are focused on the claims of debtor’s creditors as well as recovering of debtor’s solvency or its liquidation. The date when administrator is appointed is the beginning of the bankruptcy process.

Bankruptcy process might be initiated (Article 27-2 of Kyrgyz Republic “On bankruptcy (insolvency)”): creditor (several creditors); debtor; bankruptcy government body.

Proceedings that might be applied after initiating of the bankruptcy process or in the course of debtor’s bankruptcy are special administration (liquidation (with regard to legal entity), reorganization (with regard to legal entity), and bankruptcy of private entrepreneur) and reorganization, rehabilitation, amicable agreement.

According to Law of the Kyrgyz Republic “On bankruptcy (insolvency)”, methods of special administration consists of:

i. Liquidation, which is applied in respect to the legal entity; provides for seizure, alienation as well as subsequent distribution of debtor’s assets included into liquidation estate in favor of its creditors; when the liquidation proceedings are completed, record in the State Register of Legal Entities is voided and the activity of the debtor is terminated.

ii. Reorganization of the debtor-legal entity. The present method is used with regard to the legal entity; it provides for replacing of the participant (participants) and establishing of a new or several new legal entities; a new or several new legal entities as well as remained assets of the debtor are sold (alienated) in order to meet the claims of creditors; when the restructuring proceedings are completed the activity of the debtor is terminated.

iii. Bankruptcy of individual entrepreneur is applied with respect to the individual, who is registered as the individual entrepreneur; the process is carried out through the courts; provides for seizure and alienation as well as subsequent distribution of assets included into liquidation estate in favor of its creditors; the court may disqualify the individual entrepreneur, that is, prohibit it to carry out entrepreneurial activities within a given time.

When the bankruptcy process is initiated, there might be applied the following procedures:

i. Sanation. The present procedure is applied to the legal entity; provides for availability of special guarantees to protect the interests of creditors and complete payment of their claims within a given time; if the reorganization is successfully conducted and the debtor will be able to restore its solvency, then it may continue its economic activities; does not provide for changing of participants, unless otherwise provided by agreement of the parties.

ii. Rehabilitation, which is applied towards both a legal entity and individual entrepreneur; it is conducted with regard to the individual entrepreneur only through the courts; provides for presenting of the rehabilitation plan by the debtor and approval thereof by the creditors; rehabilitation plan allows continuing of the debtor’s business activity for complete or partial meeting of creditors’ claims; may transfer to the procedure of special administration; does not provide for changing of participants, unless otherwise provided by agreement of the parties.

iii. Amicable agreement is applied in the bankruptcy process juridical both with regard to the legal entity and individual entrepreneur; provides for agreements between debtor and creditors wherein the latter agrees with meeting of all or part of requirements on a contractual basis without appointing of the administrator by court; does not provide for changing of participant (participants), unless otherwise provided by agreement of the parties.

Nevertheless, they use only special administration procedures in practice – liquidation and reorganization. Bu the method of special administration procedure – reorganization is used only in respect to state enterprises and enterprises with government share in enterprise capital. Such

bankruptcy proceedings as sanation, rehabilitation and amicable agreement, focused on the restoration of the activities of the enterprise in default, have never been applied from the beginning of the bankruptcy institution's work in Kyrgyz Republic.

### **3.2. Bankruptcy government authority**

As it is known, bankruptcy institution began to establish in Kyrgyz Republic when there was adopted Law of the Kyrgyz Republic "On bankruptcy (insolvency)" on January 15, 1994. In order to create organizational, economic and other conditions required for implementation of acts on bankruptcy, there was established enterprises reorganization and liquidation administration under the Decree of Kyrgyz Republic dated May 28, 1994. Later the Bankruptcy Administration became a legal successor of the Administration. The Bankruptcy Administration was transformed into Bankruptcy Department under the Decree of the Kyrgyz Republic Government dated October 29, 2009. At the moment Bankruptcy Department is under the Ministry of economy and antimonopoly policy.

According to the Article 17 of Law of the Kyrgyz Republic "On bankruptcy (insolvency)", the Bankruptcy Department was awarded a status of government bankruptcy authority, which exercises state policy in the field of bankruptcy and prevention of the same.

Since adoption of Law of the Kyrgyz Republic "On bankruptcy (insolvency)" dated October 15, 1997 and subsequent adoption of Laws of the Kyrgyz Republic "On introduction of amendments and additions into Law of the Kyrgyz Republic "On bankruptcy (insolvency)" dated June 17, 2002 and "On introduction of amendments and additions into certain legislative acts of Kyrgyz Republic" dated June 22, 2002, the authorities of the Bankruptcy Department were significantly broadened. Thus, Bankruptcy Department together with the authorities that were earlier provided began also to carry out: licensing of the activities of administrators and their attestation; appointment, disqualification and dismissing of administrators; initiating of bankruptcy process procedures of debtors wherein the government acts as a creditor; consideration of cases on administrative violations; submission of conclusions on administrator's reports to the court; control over the execution of bankruptcy legislation requirements by administrators.

One of the areas of activities of the Bankruptcy Department is to record and analyze large insolvent, economically and socially significant economic entities, submission of proposals concerning their financial rehabilitation. The present function proposes analyzing of financial and economic indicators based on the accounting reports.

According to the Law of the Kyrgyz Republic "On bankruptcy (insolvency)", licensing of the activities of persons carrying out bankruptcy proceedings, is one of the main functions of the Bankruptcy Department (collection of documents, organizing the activities of license commission, holding of proficiency examinations and re-attestation of administrators, checking of persons aspiring to carry out administrators activities in the internal affairs bodies, maintenance of administrators register, preparation of documents for revocation of licenses). Thus, Bankruptcy Department performs organization work in terms of preparation and conduction of sessions of the license commission.

Bankruptcy is a complicate and fine element of economy, we need there very careful and competent approach, which defines a need for narrow specialization. For successful work of Bankruptcy Department particularly focused on improving of regulatory legal base, we need to analyze regulatory legal base and study experience of departments engaged in the issues of bankruptcy and prevention of the same of the near and far-abroad countries. However, the Bankruptcy Department has no relations with such departments.

### **4. Conclusions**

1. Bankruptcy institution is an integral part of the market economic system. Bankruptcy institution in Lithuania and Kyrgyz Republic has recently begun to develop and there are shortcomings in this field. Improving the Bankruptcy institute's work shall improve country's economy in whole. Lithuania chalked up in working with enterprises in default as compared to

the Kyrgyz Republic. Kyrgyz Republic is able to improve the work of the field by studying Lithuania's experience and borrowing positive results of the bankruptcy institution.

2. In Lithuania there are used such bankruptcy processes as: liquidation, restructuring and composition with creditors. It should be noted that all the proceedings specified in the Enterprise Bankruptcy Law of the Republic of Lithuania are used in the work with enterprises in default. It means the bankruptcy institution of Lithuania is trying to recover the activities of the enterprise in default but not dissolve it.

Bankruptcy institution of Lithuania pays much attention to the restructuring. In 2001 there was adopted the Law on Restructuring of Enterprises. It enables the bankrupt enterprises to recover their activities, but not to terminate them, which is negative result for both the enterprise itself and country's economy in whole.

3. In Kyrgyz Republic there are applied such bankruptcy proceedings as: liquidation, reorganization, sanation, rehabilitation and amicable agreement. But, they use only special administration proceedings in practice – liquidation and reorganization. In addition, procedure of restructuring is used only to state enterprises. Private enterprises are only dissolved.

4. Both of countries Lithuania and Kyrgyz Republic have departments involved into bankruptcy process. In Lithuania is Department of Enterprise Bankruptcy Management under the Ministry of economy. In Kyrgyzstan is Bankruptcy Department under the Ministry of economy and antimonopoly policy.

5. Over 1993–2010 in Lithuania, bankruptcy was instituted in 10 308 enterprises. Bankruptcy processes have already been completed in 6658 enterprises (64,6 percent of the total number of enterprises in bankruptcy and bankrupt enterprises). Out of that number, 6481 enterprises were liquidated, 3 – reorganized, 17 – sanified, while in the rest of 157 enterprises bankruptcy processes were terminated or composition with the creditors was concluded.

6. Unfortunately, bankruptcy statistic data of Kyrgyz Republic very limited. To 2012 year in Kyrgyz Republic in 289 enterprises bankruptcy processes are still in progress and bankruptcy processes have already been completed in 1209 enterprises. In 7 enterprises are still reorganization process and reorganization process in 2 enterprises have been completed.

7. To improve bankruptcy institution of Kyrgyz Republic, firstly we need to improve action of the existing bankruptcy laws. It is required to put in force the effect of such bankruptcy proceedings as reorganization, rehabilitation and amicable agreement and improve action of the restructuring proceeding. It means that we need to focus on the restoration of enterprise's solvency, which has already been working in the Lithuania more than 10 years.

8. The bankruptcy institution of Kyrgyz Republic needs to strengthen the protection of rights of the debtors and creditors in the bankruptcy case. The Enterprise Bankruptcy Law of the Republic of Lithuania has chapter (Chapter 5) which provides for protection of the interests of the debtors, creditors and third parties where bankruptcy proceedings have been instituted. The Law of the Kyrgyz Republic "On bankruptcy (insolvency)" not includes this kind of concept.

9. For more effective work of bankruptcy institution in Kyrgyz Republic Bankruptcy Department need to relations with such departments in other countries. It is necessary for analyzing bankruptcy institutions of other countries and using their experience in Kyrgyz Republic.

10. It is necessary to create an enterprise's bankruptcy prevention system in order to improve bankruptcy institution's work. Prediction and prevention of the enterprise's bankruptcy must be integral part of the bankruptcy institution, which shall allow reducing of the bankruptcy risk and improving of the country's economy in whole.