

# A Review on the Efficient Management of Court Receivership

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## I. Introduction

The constant maintenance, growth and development of the corporation is the basic motto and objective of a corporation. The recent intensification of the limitless competition across the national borders has resulted in significant changes in management environment. Differences in corporations's abilities to face such rapid environmental changes can now critically determine their corporate destiny. Some will prosper while others will go bankrupt.

For example, stagnation of real estate economy for recent 2 years has brought about the bankruptcy of many major construction companies such as Hanyang, Yuwon, Woosung, Kunyoung and Dongshin. This year, even big conglomerates such as Jinro, Daenong and Kia are experiencing serious debt problems.

The reasons for this bankruptcy parade vary. First, the increasing unpredictability in the market can be pointed out as the external reason for bankruptcy. The corporation's reckless expansion policy without developing its ability to manage the coming crises should be listed as the second reason.

The bankruptcy of a corporation having a certain size and gravity can lead to a huge social and economic consequences. This not only results in an imbalance of the industrial sector where the company belongs to but also threatens the survival of the companies having a relationship with it. Not to mention the conflicts among different interest owners.

Regarding these consequences, the importance of a proper management of companies who went bankrupt or show a sign of bankruptcy is increasing. The court receivership, which is based on the company clearance law, is a government method for saving those companies in crises. The main objective of the court receivership is preventing the companies, which currently face serious but temporary financial problems, from going into bankruptcy and guiding them into revitalization.

Despite the good cause of the law, this court receivership receives lots of criticism. Some say it infringes the legal spirit of fair application. For them, the court receivership is quite an exceptional and policy-orientated method which is contrary to the principle of legal rights based on the logic of free market economy.

The main academic concern of this review is examining the current problems in the application of the company clearance law. The suggestion for the improved application of this law takes another academic interest. Author's business experience as a management director will form some experimental basis of this review.

## **II. Analysis of the companies filed to the application for court receivership**

### **1. Trends**

From 1983 to 1995 the number of companies applied for court receivership was 608. Those of 358 companies received the approval from the government while 158 companies were dismissed. The approval ratio was 69% and dismissal ratio was 31%.

Besides, for the same period, out of companies which received the government approval 93 were successfully revitalized while 109 companies were cleared. The annual average number of the companies which applied for the court receivership was 33 from 1986 to 1990. From 1991 to 1995 the numbers were doubled to 69. This increasing trend in numbers of companies applied for court receivership reflects the economic depression in 1990s. The economic growth in 1980s boosted by low interest rate, depreciated dollar and low oil price resulted in the heavy investment and precarious consumption. The beneficiary factors for the economic growth in 1980s did not sustained through 1990s and the high interest rate and high wage replaced those benefits.

When it comes to the listed companies, 20 companies applied for court receivership from 1977 to 1990. The average applied companies were 1 or 2 a year. 8 com-

panies applied for court receivership in 1991, 18 companies in 1992, 5 companies in 1993 and 8 companies in 1994. This shows a remarkable increasing trend in court receivership application.

The trend seems to be related to the government's liberalization of public offering process during 1988 and 1989. Many companies with low qualification which was publicly offered met the critical condition and applied for court receivership.

## 2. The reasons for an increasing trend in number of companies applied for court receivership

In terms of listed companies, construction companies topped the bankruptcy ratio before 1990 due to the slowness in international construction boom. After 1991, out of 40 companies applied for the receivership, 13 were machinery manufacture companies, 8 were textiles companies and 5 were chemical companies.

The sudden slow-down in exports, the beginning of cyclical depression and the intensification of competition were the basic reason for the trend. To overcome these environmental difficulties, companies, in haste, propelled the business diversification and the domestic market penetration. This resulted in the excessive investment and the increase in financial expenses which became the reasons for the frequent bankruptcy. The reasons for the 62 cases of court receivership from 1984 through 1996 are listed below.

< Table 1: reasons for court receivership application >

The reasons for court receivership application	No. of companies	Detailed Explanation
Excessive investment	16	- Excessive business expansion, diversification
Business limitation (depression)	15	- Beginning of the cyclical depression, the intensification of competition and economic slow-down - ship-building, shoe-making and fishing industries
Export Slow-down	7	- Clothes, electronics and shoe-making
Excessive Financing	5	- Excessive accumulation of Debt
Unpaid Receivables	3	- Increase in unpaid receivables
Others	16	- Labor dispute, aggravation of the holding company's management, and accumulation of loss from overseas subsidiaries.
<b>Total</b>	<b>62</b>	

As can be seen from the table 1, the reasons for such application stemmed from companies's excessive expansion, lack of preparation and increase of unaffordable debts. This led to the aggravation of companies's financial status. The repetition of this excessive activities finally resulted in many bankruptcies.

Because the bankruptcies were largely caused from companies's own internal factors, the implementation of court receivership raises the question: if a company went into crisis because of its own faults where can the legal care for it obtain the justice? It can violate the fairness principle of legal application and deserve to get the social criticism.

### **III. Issues raised from the current court receivership system and the suggestion of the reform**

Even though the company clearance law stands on good legal objectives, the possibility of subjective and unfair implementation of the law and the lack of transparency attract social criticism. The court receivership brought about an issue of governmental favor among the interest groups such as companies, creditors, and business competitors. Major current issues are listed below with a possible reform suggestion.

#### **1. Objectiveness matter of the court receivership and suggestions**

The clause 30 of company clearance law prescribes 2 reasons for the company clearance initiation. Only when a company can not redeem its duties without a critical measurement and it shows a sign of bankruptcy, the clearance procedure can be initiated.

These vague legal application can not concretely guarantee the revitalization of the company. The deficiency of suitable criteria for the examination of a company's revitalization possibility requires the court too much discretion. This hinders the fairness principle of law application.

To overcome this matter, the court assigns the professional institutions to the inspector. However, the boundary of this inspection by the assigned institution is limited only to the initiation stage only when it is necessary. Furthermore, the quality of a legally appointed administrator who will manage the court receivership has not reached to the sufficient level.

The suggestions to decrease these problems are as follows. First, the probability of

whether the court receivership can be successfully implemented should be checked. Second, the detailed explanation on the court receivership initiation should be publicly announced before making-up the decision. This can minimize the conflicts among different interest groups which can be derived from the vagueness of the decision making. Third, the boundary of assigned inspectors' participation should be extended to the whole court receivership procedure.

## **2. Revitalization efforts under the court receivership**

First, there is a matter of revitalization plan implementation. As stated on the sub-condition 2 of condition 1 in clause 233 of the law, revitalization plan should be fair and probable for the court receivership initiation. It is quite rare that the initial plan is executed as it originally planned. Frequent changes in the original plan many times bring about the cancellation of the court receivership.

This implementation problem on the one hand is caused by the worsening of business environment.

On the other hand it is largely caused by the difficulty of getting creditors' concession.

To improve this matter, the appointed inspector should play an important role for the establishment of the revitalization plan. The inspection period by the appointed analyst should be extended to the end of the court receivership. Pressing more responsibility to the appointed administrator for the completion of the plan can be helpful for the sound and practical establishment of the revitalization plan.

Second matter is related to the company's self-rescue efforts. On the surface, most of the companies under the court receivership seem to make efforts for their self-rescue. But in reality, the self-rescue plan does not involve the significant measures. The self-rescue efforts made by the companies under the court receivership do not exceed those of ordinary companies. Due to the wrong recognition that the court receivership will function as an automatic protection for the company regardless of their desperate efforts.

To solve this problem, clause 487 of the supreme court rule effected from July, 1996 states that the appointed manager should report the implementation process to the creditors once a year and the audit of the company by the CPA should be done in every 2 years.

As a suggestion for a more aggressive supervision of plan implementation, the

court can appoint the standing auditor supervising the management condition more often than it used to be. The frequent visit to the company by the creditors, the court and other interest groups, whether it is periodical or not, can be another suggestion for the sound management of the company.

### 3. The legal appointment of the administrator

The administrator plays many important roles as a representative of the company, an agent of the various interest groups and a public trustee for the management and clearance of the company's property and business activities.

Condition 1 in the clause 94 of the law states that to be the legal administrator an applicant should not own any interest related to the company. That is to say, the person who does not know the company and shares less responsibility and motive is selected as the administrator.

The joint-administration system was introduced in 1996 for more discrete decision making by 2 appointed administrators. But the negative effect of this joint-administration system is considerable. The annual expense for one administrator reaching around Won 100 million is very high. Besides the role differentiation between 2 administrators is difficult and thus the decision making costs more time and expenses.

The law prohibits the administrator from the involvement of the personal interest to the company, which means that the administrator can be irresponsible for the management results.

These administration problem raise questions. Is the legal administrator necessary? Should the administrator always be sought outside the company? In the assumption that the reason of the company's crises is not resulted from the lack of the management skill and the corruption but from the temporary external factors, giving one more chance to the old top managers can be a better choice of the court and creditors. As the old high ranking managers are well acquainted with the business they can definitely play important roles for the revitalization of the company.

The objective of the joint-administration, the prevention of conspiracy between the old company owner and the appointed administrator, can be achieved through a more simple measure, the appointment of standing auditor. If the joint-administration is necessary for the revitalization of the company, then the role differentiation should be made up clearly.

#### **4. Management of the company for the revitalization**

The court exercises 2 methods for the management supervision. One is giving an approval for each management decision and the other is receiving management reports periodically. This methods are passive as they only checks the problem and do not initiate the plan. As the court interference to the management is too broad, the administrator's own judgment and experiences are restricted to be reflected to the management.

The company seeks for the long-term development of the business while the court focuses on the redemption of company's debts. Due to the concentration of the steering power to the court, the company, in most of times, has to give away to the court's decision. By these reasons, many companies released from the court receivership go into repetitive critical condition.

The strict restriction on company's foreign investment and ware-housing deprives the company of many essential discretionary rights for the management. The restriction should be alleviated down to the level posed to the ordinary companies.

#### **IV. Requirements for the successful revitalization of the company**

So far 4 major issues for the improved application of court receivership procedure have been explained. In this chapter the factors which are crucial to the success of revitalization will be explained. The analysis is partly based on the author's personal experience.

##### **1. Personnel management**

In terms of employment, many companies under the court receivership tend to minimize the size of the organization. Apart from this, the crisis of the company makes employees feel insecure and forces them to seek for another company. This can bring about a serious problem in a company's recruitment scheme and personnel management. And, the problem on personnel management, caused by employees feeling of insecurity and worsening welfare system comparing with others, will be a serious matter of the company time after time until the company is out of the court receivership. On other hands, the company will face same matter on new staff re-

cruitment caused by the same reasons with the problem of personnel management. So, if the company can sustain its previous personnel management level even after the court receivership application it has high potential for the revitalization.

For the stable personnel management, the company should be able to make continuous increase in employee's welfare benefits and wages. In addition, showing the good vision and trust to the employees is important.

## **2. Professional management**

When a company is under the court receivership, it can delay its payment of debts until it recovers the sound financial structure. The court receivership, however, does not provide the company with other protective methods for its business refinement and competitiveness improvement. That is why the professional management assignment by court is very important and essential thing to the success of the company's revitalization. So, the management elected by court should be talented enough to be a central figure as a leader and have various experiences and abilities to make proper decisions and execute the unique strategy. The management should, also, have entire understandings of the business strategy, which the company has been cultivated and implemented, in order to maintain the strategy continuity and keep the company's unique culture. Furthermore, he have to be aggressive in investment and development of new business after he has a confidence on the competitiveness of the company.

When court receivership is applied for the company, it is often the case that a legally appointed administrator who is in lack of the professional knowledge on the company is in charge of the company's whole management. This can breach the company's strategic consistency. The well arranged long-term management plan of the company can also be discarded easily without a professional investigation. The harmony between the appointment of administrator and the maintenance of the company's competitive points should be considered with care.

## **3. The prompt and correct decision making**

The decision making procedure of a company under the court receivership is complicated. To make a decision, it takes more time for the company because the approval system requires it. This can hinder the company from responding timely to the



rapidly changing environment, which can cause another critical problem to the company.

In the modern business management trends, the speed in decision making is treated a crucial factor to the profitability. With a regard to the trends, most of company have trends to reduce the internal approval steps for rapid decision—making. When the company under the court receivership makes a management decision, it needs to get a court approval, except internal approval system, which takes 4 steps: document filing, approval application, court examination and final decision—making. This can easily delay the appropriate decision for more than 2 or 3 days , so the decision becomes out of date. The company under the court receivership should put more endeavors to build up the speedy decision making procedure .

#### **4. Employee consciousness**

Whether the company is in an ordinary situation or under the court receivership, the consciousness of its employees heavily influences the business management. This consciousness is formed through the company's management culture, management philosophy and the trustfulness.

When the company files for the court receivership, the employees make a decision whether they are going to stay at or leave the company. After this voluntary employment arrangement the consciousness of the remained employees affects the sound management of the company. If the remained employees hold a strong belief in the revitalization of the company and act with voluntarism, the possibility of early recovery is high. If the employees belief in revitalization is vague, the company will have lesser chances to recover. The company's successful revitalization much depends on employee's strong belief in it.

#### **5. Appropriate management by the court**

As a public institution, the court must consider all parties interests linked to the company revitalization procedure. So, the appropriate management means making compromises and maintaining balance of all interested parties. At last, the company's revitalization is ultimate means to fulfill the obligations to the interested parties.

Though the company's interest, a member of the interested parties, is as important as that of the creditors and shareholders, it does not seem to be properly addressed by the court. The redemption of the company's debt can not be executed without a

careful consideration on the company's overall and sound revitalization. The court's bias to the creditors should be neutralized.

So, the court should give the more right of self-control to the company, if the company accumulate enough capability to make redemption of its debt. It means the company has to have a new phase to prepare the future business structure after the fulfillment of its debt redemption schedule.

Based on the purpose of the court receivership, the relief of the entire interested parties, the court should consider the company under the court receivership as a member of the interested parties and include the competitiveness of the company as major factor for the future after the revitalizations when the court makes a decision.

## V. Concluding remarks

The objective of the company clearance law is the rescue of financially strapped companies having high possibility of revitalization. In other words, that is the revitalization of the company and the rescue of related interest groups.

Though the law stands on the sound objective, its application and management reveal many procedural problems. As the court announced the reform of the court receivership in June, 1996, the problems became less serious. However, the objectiveness of the court receivership initiation, the management of inspectors activities, the appointment of the administrator and the joint management system are still far from the business reality.

In addition, the revitalization procedure is too much focused on the redemption of the debts. The company's own logic of revitalization is often ignored.

Under the current appointment system, the legally appointed officer who does not own any interest in the company's revitalization cannot have enough responsibility and motive to be driven to the revitalization procedure. Endowing the stock ownership to the legally appointed manager can be one way of boosting his responsibility and commitment. The provision of a certain position to the legally appointed manager even after the revitalization can be considered.

For the successful implementation of the court receivership, the management should be focused more on the activation of the shrunken business than on the regulation and limitation of it. So long as both the redemption of the debts and the reconstruction of the company are pursued with equal gravity, the court receivership system can contribute to the social and economic development of the country.