
This is the accepted version of the paper.

This version of the publication may differ from the final published version.

Permanent repository link: http://openaccess.city.ac.uk/12033/

Link to published version:

Copyright and reuse: City Research Online aims to make research outputs of City, University of London available to a wider audience. Copyright and Moral Rights remain with the author(s) and/or copyright holders. URLs from City Research Online may be freely distributed and linked to.
TITLE:
THE POST-1986 UK INSOLVENCY SYSTEM: A
STUDY OF MODE OF RESOLUTION AND OF
COMPANY OUTCOME.

NAME: ABDUL KARIM KARGBO

PhD THESIS

CASS BUSINESS SCHOOL, CITY UNIVERSITY,
london

MAY 2009.
CONTENTS

LIST OF TABLES vi

LIST OF FIGURES ix

ACKNOWLEDGEMENTS x

ABSTRACT xi

CHAPTER 1: INTRODUCTION 1

1.0 Background and Motivation 1

2.0 Why Conduct the Study in the UK 2

2.1 Differences between Debtor- and Creditor-Oriented Codes 3

2.2 Types of Research on the UK Creditor-Oriented Code 4

3.0 Why the Chosen Period is Important 4

4.0 Limitations of the Study 6

5.0 Structure and Contribution of the Thesis 7

CHAPTER 2: THE UNITED KINGDOM INSOLVENCY CODE 13

2.1 Introduction 13

2.2 Types of Charges in the UK Insolvency Code 13

2.2.1 Fixed Charge 14

2.2.2 Floating Charge 14
2.3 Priority Ladder in the UK Insolvency Code

2.4 The Insolvency Process – The UK Code: Pre-1986

2.4.1 Scheme of Arrangement

2.4.2 Receivership

2.4.3 Liquidation

2.4.3.1 Members’ Voluntary Liquidation

2.4.3.2 Creditors’ Voluntary Liquidation

2.4.3.3 Compulsory Liquidation

2.5 The Insolvency Process – The UK Code: Post Insolvency Act 1986

2.5.1 Administrative Receivership

2.5.1.1 Administrative Receiver’s Appointment and Procedures

2.5.1.2 Powers of the Administrative Receiver

2.5.2 Administration Procedure

2.5.2.1 Administrator’s Appointment and Procedure

2.5.2.2 Powers and Duties of the Administrator

2.5.3 Company Voluntary Arrangement (CVA)

2.6 The Insolvency Process – The UK Code: The Enterprise Act 2002

2.7 Conclusion

CHAPTER 3: LITERATURE REVIEW AND HYPOTHESES SETTING

3.1 Introduction

3.2 Review of Literature on ‘Determinants of the Resolution Form Between Administration and Administrative Receivership in the UK’

3.2.1 Bankruptcy Costs
3.2.2 Information Asymmetry 47
3.2.3 Intangibles 49
3.2.4 Ability to Raise Funds 52
3.2.5 The Economic Cycle 55
3.2.6 Creditors’ Complexity 57
3.2.7 Conclusion 62

3.3 Review of Literature on ‘The Characteristics of Firms Entering Administration in the UK and the Difference Between Those Reorganising Compared with those Liquidating’. 62

3.3.1 Financial Distress 63
3.3.2 Size 66
3.3.3 Liquidity and Solvency 68
3.3.4 Ability to Raise Funds 71
3.3.5 Profitability and Earnings Prospects 74
3.3.6 Economic Cycle 76
3.3.7 Time in Administration 77
3.3.8 Management Stability/Efficient Management Retention Hypothesis 78
3.3.9 Relationship Banking in Administration 81
3.3.10 Conclusion 83

3.4: Review of Literature on ‘The Subsequent Performance of UK Firms Reorganised in Administration’ 84

3.4.1 Liquidity and Leverage 85
3.4.2 Operating Performance/Profitability 88
3.4.3 Restructuring/Downsizing 90
3.4.4: Conclusion 92
CHAPTER 4: DATA AND METHODOLOGY 94

4.1 Introduction 94

4.2 Data, Sample Source, and Period 94

4.2.1 Determinants of the Resolution Form between Administration and Administrative Receivership in the UK 94

4.2.2 The Characteristics of Firms Entering Administration in the UK and the Difference Between Those Reorganising Compared with those Liquidating 99

4.2.3 The Subsequent Performance of UK Firms Reorganised in Administration 100

4.3 Overview of the Data 102

4.4 Methodology 104

4.4.1 Linear Probability Model 105
4.4.2 Multiple Discriminant Analysis (MDA) 106
4.4.3 Probit Model 108
4.4.4 Logistic Model 110

4.5 Variables Used in the Chapter on ‘Determinants of the Resolution Form between Administration and Administrative Receivership in the UK’ 113

4.6 Variables Used in the Chapter on ‘The Characteristics of Firms Entering Administration in the UK and the Difference Between Those Reorganising Compared with those Liquidating’ 117

4.7: Variables Used in the Chapter on ‘The Subsequent Performance of UK Firms Reorganised in Administration’ 120

CHAPTER 5: DETERMINANTS OF THE RESOLUTION FORM BETWEEN ADMINISTRATION AND ADMINISTRATIVE RECEIVERSHIP IN THE UK 123

5.1 Introduction 123

5.2 Motivation and Summary of Hypotheses and Results 124

5.3 Results 127

5.3.1 Univariate Statistics 128
## 5.3.2 Multivariate Analysis

### 5.4 Conclusion

### CHAPTER 6 THE CHARACTERISTICS OF FIRMS ENTERING ADMINISTRATION IN THE UK AND THE DIFFERENCE BETWEEN THOSE REORGANISING COMPARED WITH THOSE LIQUIDATING

#### 6.1 Introduction

#### 6.2 Motivation and Summary of Hypotheses

#### 6.3 Results

- 6.3.1 Univariate Statistics
- 6.3.2 Multivariate Analysis

#### 6.4 Conclusion

### CHAPTER 7: THE SUBSEQUENT PERFORMANCE OF UK FIRMS REORGANISED IN ADMINISTRATION

#### 7.1 Introduction

#### 7.2 Motivation, Expectations and Summary of Findings

#### 7.3 Results

- 7.3.1A Liquidity
- 7.3.1B Leverage
- 7.3.2 Operating Performance
- 7.3.3 Labour and Asset restructuring

#### 7.4 Conclusion

### CHAPTER 8: CONCLUSION

#### 8.1 Overview of Thesis
8.2 Strength of the Thesis and its Contribution 180
8.3 Weaknesses of the Thesis 182
8.4 Future Research 184

REFERENCES 188

LIST OF TABLES

TABLES OF CHAPTER 1 201

1.1 Number of Companies in Administration and Administrative Receivership in the UK from 1990 to 2002 201

TABLES OF CHAPTER 2 202

2.1 Definition of Absolute Priority Rule (APR) 202

TABLES OF CHAPTER 3 203

3.1 Summary of Studies on Bankruptcy Costs 203
3.2 Summary of Prior Studies in the Reorganisation versus Liquidation Literature with Size a Significant Variable 205
3.3 Summary of Prior Studies in the Reorganisation versus Liquidation Literature with Size not Significant 206
3.4 Effect of Free Assets on the Reorganisation of Firms 206
3.5 Definitions of Financial Distress 207
3.6 Summary of Studies on the Effect of Liquidity Risk, Solvency Risk, and Debt Covenant Violation on Reorganisation. 208

TABLES OF CHAPTER 5 210
5.1 Administration and Receivership Filings 210
5.2 Definition of Variables 211
5.3A Descriptive Statistics and Univariate Tests 212
5.3B Descriptive Statistics and Univariate Tests 213
5.4A Correlation Matrix 214
5.4B Correlation Matrix 214
5.5A Logistic Models on Determinants of the Resolution Form Between Administration and Administrative Receivership 215
5.5B Logistic Models on Determinants of the Resolution Form Between Administration and Administrative Receivership 216

**TABLES OF CHAPTER 6** 217

6.1A Time Series of Companies that Reorganise and Liquidate in Administration: Sample 1 217
6.1B Time Series of Companies that Reorganise and Liquidate in Administration: Sample 2 218
6.1C Time Series of Companies that Reorganise and Liquidate in Administration: Sample 3 219
6.2 Definition of Variables 220
6.3A Descriptive Statistics and Univariate Tests: Sample 1 221
6.3B Descriptive Statistics and Univariate Tests: Sample 2 222
6.3C Descriptive Statistics and Univariate Tests: Sample 3 223
6.4A Correlation Matrix: Sample 1 224
6.4B Correlation Matrix: Sample 2 224
6.4C Correlation Matrix: Sample 3 225
6.5A Logistic Models: Sample 1 226
6.5B Logistic Models: Sample 2 227
TABLES OF CHAPTER 7

7.1 Number of Reorganised Companies in Administration by Year

7.2 Definition of Variables

7.3 Descriptive Statistics for Differences in Means and Medians:
   7.3A Two Years Before to the Appointment of the Administrator
   7.3B One Year Before to the Appointment of the Administrator
   7.3C Year of the Appointment of the Administrator
   7.3D One Year after the Appointment of the Administrator
   7.3E Two Years after the Appointment of the Administrator
   7.3F Three Year after the Appointment of the Administrator

7.4 Mean and Median Peer-Adjusted Ratios Two Years Before to Three Years After:
   7.4A Current ratio (CR)
   7.4B Liquid ratio (LIQ)
   7.4C Total liabilities to total assets ratio (TLTA)
   7.4D Operating profits before interest tax, depreciation and amortisation to total asset ratio (EBITDATA)
   7.4E Operating profits before interest and tax to total asset ratio (EBITTA)
   7.4F Logarithm of total assets (LNTOTA)
LIST OF FIGURES

FIGURES OF CHAPTER 1

1.1 Graphs of Number of Companies in Administration from 1990 to 2002 237
1.2 Graphs of Number of Companies in Receivership from 1990 to 2002 237
1.3 The Path Through Insolvency Proceedings as Studied in Thesis. 238

FIGURES OF CHAPTER 4

4.1 Floating Charge Proportion in Administration and Administrative Receivership from 1996 to 2001 239
4.2 Fixed Charge Proportion in Administration and Administrative Receivership from 1996 to 2001 240

Appendix 241
ACKNOWLEDGEMENTS

First of all, I would like to thank The Almighty God for giving me the ability, health, and strength to cope with the demands of the PhD programme.

I would also like to express my profound gratitude and respect to my supervisors, Professor David B. Citron and Dr. Maria Carapeto, for their advice, encouragement, and most of all support throughout my studies at Cass Business School, City University. They kindly assisted me in every way possible to get to this point.

I also want to thank the Commonwealth Scholarship Commission for their financial and other assistant granted to me in the United Kingdom. It would not have been financially possible without their support.

I would like to thank Professor Meziane Lasfer for his help during the initial stage of my work.

Finally, I would like to say thanks to my father, Mr. Sharka M. Kargbo for his support, in every which way, over the years, and to my brother, Lamin Kargbo, for his assistance during desperate times. And to all those who have directly or indirectly contributed to this work, I want to say thanks.
ABSTRACT

This thesis empirically investigates the United Kingdom (UK) insolvency code by focusing on the formal procedures available to distressed firms in the UK. The UK insolvency code is characterised as a creditor-oriented system that enforces a binding agreement between the company and the creditors with a view to maximising payouts to the creditors. However, the government has introduced two major legislative changes – the Insolvency Act 1986 and the Enterprise Act 2002 – to move the UK insolvency code away from its creditor-orientation and towards a system that will increase the chances of distressed, but viable, firms in the UK to reorganise.

The introduction of the Insolvency Act 1986 paved the way for distressed companies in the UK to enter into a formal procedure (administration) specifically introduced as a means of encouraging a culture of reorganisation for distressed firms in the UK. This thesis investigates the functioning of the UK code, by focusing on the two main formal procedures available to distressed firms (administration and administrative receivership) after the introduction of the 1986 Act. The introduction of the Enterprise Act 2002 resulted in the abolition of the administrative receivership procedure while maintaining the administration procedure as the key formal rescue procedure in the UK insolvency code. Hence, conducting research in the UK formal insolvency procedure is important as it provides empirical evidence on the administration procedure, which is now the main rescue vehicle under the Enterprise Act 2002. The thesis focuses on the post-1986 regime in the UK. It consists of 8 chapters including 3 empirical chapters.

Chapter 5 examines a large sample of UK firms that initiated administration or administrative receivership procedures between 1996 and 2001. The aim is to investigate the choice of the resolution form between administration and administrative receivership. The main research question is to investigate whether the newly introduced administration procedure catered for firms with a different set of financial and other characteristics to those that entered administrative receivership. The findings show that there are some distinguishing characteristics between firms entering administration and those entering administrative receivership, implying that administrative receivership was not necessarily the most appropriate insolvency procedure for all distressed firms.

Chapter 6 examines a sample of UK firms that entered administration between 1996 and 2001. The aim of this chapter is to investigate the differences between firms that reorganised in administration versus those that liquidate. The key issue here is whether administration procedure can differentiate between firms potentially likely to survive and those likely to fail. The findings show that there are significant differences between firms that reorganise and those that fail in administration, suggesting that the administration procedure is able to discriminate between viable and non-viable firms.
Chapter 7 examines the subsequent performance of UK firms that reorganised in administration between 1996 and 2001 relative to a matched sample firms from the same industry and of relatively the same size. The aim was to assess the subsequent performance of companies that reorganise in administration using several key ratios, covering the period from two years prior to failure until three years afterwards. The results show significant improvements in the financial performance of reorganised firms, relative to a matched sample firms, during the period after entering administration.

In summary, these results show the importance of introducing the administration procedure in the Insolvency Act 1986. Prior to this date, there was the possibility that some of those firms that reorganised in administration post-1986 might have been liquidated as there was no formal procedure aiming to reorganise distressed firms at that time. The findings clearly show the potential of the administration procedure in attracting distressed firms capable of reorganising. That procedure has now become the foundation upon which the UK insolvency code is built as indicated by the Enterprise Act 2002. However, having said that, the 1986 system also opened the way for severely distressed companies that should have been liquidated speedily in administrative receivership to attempt reorganisation in administration, thus wasting those firms’ already severely depleted resources further. In my opinion, the Enterprise Act 2002 should safeguard against this by putting in place procedures to prevent economically distressed companies from attempting to reorganise in administration.