

**BUSINESS-RELATED BANKRUPTCIES UNDER THE
BANKRUPTCY (SCOTLAND) ACT 1985 (AS AMENDED)
SCOPING STUDY**

Lambda Research and Consultancy Ltd.

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2002**

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CONTENTS	Page
Summary	i
1 Introduction	i
2 Approach	i
3 Bankruptcy	ii
4 Practice issues identified	iii
5 Issues for a main study	vi
6 Conclusions and Recommendations	xi
1 Introduction	1
1.1 Background	1
1.2 Requirements	1
1.3 Approach	2
2 Bankruptcy and Sequestration	3
2.1 Introduction	3
2.2 The objectives of sequestration	3
2.3 The process of sequestration	4
2.4 Pathways to sequestration	5
2.5 An alternative to sequestration – protected trust deeds	7
2.6 The debtor’s experience of sequestration	9
2.7 Concerns about trustees	10
2.8 The effectiveness of sequestration	10
2.9 Potential for rescuing businesses in difficulty	12
2.10 The impact of bankruptcy law on enterprise	12
3 Key Issues in the Study of Business-Related Bankruptcy	14
3.1 Introduction	14
3.2 Distinguishing between business-related and consumer bankruptcy	14
3.3 Assessing debtor responsibility for bankruptcy	17
3.4 Outcome of bankruptcy for the business	19
3.5 Relative effectiveness of sequestration	19
4 Main Study – Objectives	20
4.1 Introduction	20
4.2 Addressing the objectives	20
4.3 Information to be gathered	21
5 Main Study - Methodologies	24
5.1 Introduction	24
5.2 Literature review	25
5.3 Statistical data collection	26
5.4 Questionnaire surveys	28
5.5 Interview surveys	29
5.6 Case studies	29
5.7 Review of sources of advice and support	30

5.8 Action research	30
6 Main Study - Feasibility	33
6.1 Introduction	33
6.2 Collection of retrospective data	33
6.3 Collection of current data	34
6.4 Questionnaire surveys	35
6.5 Case studies	36
6.6 Action research	37
7 Recommendations for a Main Study	38
7.1 Introduction	38
7.2 Options	38
7.3 Recommendations	40
Annex A - Glossary of Terms	42
Annex B – Interviews Undertaken in the Scoping Study	45
Annex C – Insolvency/Bankruptcy Literature References	46

Tables, Charts and Figures

Table 1. Summary of approaches to defining business-related bankruptcy	iv
Table 2. Contribution of different methodologies towards required information	ix
Table 3. Summary of feasibility issues	xi
Table 4. Approaches to defining business-related bankruptcy	16
Table 5. Contribution of different methodologies towards required information	26
Table 6. Summary of feasibility issues	40
Chart 1 – Debtor & creditor petitions for sequestration and protected trust deeds	8
Figure 1 – The continuum of bankruptcies	16

Summary

1 Introduction

- 1.1 In 2000, the Scottish Executive commissioned a scoping study to explore the requirements for more detailed research to examine the impact of business-related bankruptcy on business start-up and growth in Scotland. The Scottish Executive's policy focus is on business start-up, growth and survivability. However, it has been acknowledged that Scotland has displayed a lower than expected business birth rate, and that a significant proportion of these new-start businesses fail within a few years. Ministers of the Scottish Parliament expressed a commitment to achieve a higher business birth rate in Scotland, and a reduction in the business failure rate, resulting in an overall increase in business activity. Against this background there has been some concern that the process of sequestration, leading to the bankruptcies of business owners and partners, could be having an inhibiting effect on business start-ups: that entrepreneurs might be dissuaded from taking business risks where they are aware of the potential impact of current bankruptcy law should they fail. Equally, there is concern that those business people who are made bankrupt may be deterred from trying again.
- 1.2 Part of the problem in Scotland is the “stigma attached to business failure”. It has been suggested that the Scottish parliament should “applaud business success and be less critical of business failure”, and should encourage “entrepreneurs who have experienced genuine failure to get back into risk-taking”. In December 1999 the Entrepreneurial Exchange published a paper proposing that “rather than punish and discourage those who fail [in business] we must encourage them to try again”.
- 1.3 The failure of a small proportion of businesses results in the personal bankruptcy of the entrepreneur, working as a sole trader or partnership, or having given personal guarantees on loans made to a limited company. The Entrepreneurial Exchange views existing bankruptcy law as effectively punishing those who fail in business, and therefore feels that it acts as a barrier to enterprise, and suggests that there should be significant reforms to the law. Meanwhile, in England and Wales, an awareness of the need to reduce the financial and social consequences of those business failures which lead to bankruptcy has also been developing, and in March 2000 the Department of Trade and Industry’s Insolvency Service published a consultation document¹, suggesting possible reforms to the law.
- 1.4 This current study undertook a variety of research activities to explore how current bankruptcy legislation works in Scotland, what is known about the incidence of business-related bankruptcy, and what the impact is of bankruptcy on those who experience it, as well as on those who may simply see it as a possibility in the future.

2 Approach

- 2.1 The research approach for the scoping study contained four main elements:

¹ Bankruptcy – A Fresh Start, Department of Trade and Industry, March, 2000

- A literature search - to identify literature relevant to insolvency in general, and to business-related bankruptcy in particular, both in Scotland and in other jurisdictions;
- an analysis of existing data sources that provide information about bankruptcies in Scotland - to evaluate the extent to which they enable the numbers and characteristics of business-related bankruptcies to be identified;
- interviews with people affected by bankruptcy either personally or in a professional capacity - to gather information about the causes, process and impact of bankruptcy, to explore the views and experiences of those interviewed, and to identify potentially relevant issues. The interviews were followed up by two workshops – one for those with personal experience of bankruptcy and one for those who have professional involvement – with a view to feeding back the main findings of the scoping study research, validating these findings, and identifying any gaps;
- an assessment of potential research methodologies and approaches for use in a main study, including examination of their feasibility, and the potential risks and benefits. This has also included analysis of the likely costs of a main study, and of timescales for the study, and has involved the development of a detailed research specification for the study.

3 Bankruptcy

3.1 Current bankruptcy law in Scotland has three main objectives:

- to serve the economy and society as a whole, ensuring a climate in which debts are generally paid, by acting as a deterrent to non-payment;
- to provide for the repayment of debts to creditors: in sequestration the debtor's assets pass to a trustee, whose duty it is to realise them and distribute them equitably to all creditors;
- to provide relief to debtors unable to pay their debts: with sequestration, creditors can no longer exercise debt-recovery procedures against the debtor, whether formal or informal, and the debtor is generally discharged after three years irrespective of whether the debts have been paid².

3.2 In contrast with some other jurisdictions, Scottish bankruptcy law does not place emphasis on protecting the business, the business's employees or the debtor's family, and may be considered more creditor-orientated than much bankruptcy law in continental Europe and the USA. Bankruptcy law does not currently provide for an independent assessment of the viability of a business, or for attempted business rescue, prior to sequestration. This is an important point to which we return later in the report.

² The trustee can ask for a deferment of discharge on specified grounds, including if the debtor has failed to co-operate or is suspected of committing offences.

- 3.3 The process of sequestration, which results in a person being declared bankrupt, is relatively simple and easy to invoke, but largely ineffective in recovering much of the debts owed to creditors. It is also very much more difficult to reverse, where a mistake has been made or a change of circumstances arises. Creditors tend to view sequestration as a last resort, except in specific circumstances - the Inland Revenue and Customs & Excise, for example, will tend to use it to prevent further debts building up. Debtors, however, who can petition the courts for their own sequestration, are tending to use it more frequently as a means of seeking relief from a burden of debt.
- 3.4 Most creditors, prior to petitioning for sequestration, will try other means of debt recovery and diligence - the formal processes of seeking the recovery of debts, including such actions as poinding and warrant sales³. The interaction between informal debt recovery processes, diligence and sequestration is quite complex, and varies markedly between different types of creditor, and according also to the characteristics of the debtor and of the debt. There is no simple or consistent route that creditors follow. Rather decisions about debt recovery methods tend to be based on business considerations - the cost of the process in relation to the expected return.
- 3.5 As an alternative to sequestration, Scottish law provides for the use of a trust deed. A trust deed is a formal, legally binding contract between a trustee and a debtor, entered into voluntarily, under which a trustee administers the debtor's assets for the benefit of his creditors. A protected trust deed (trust deeds automatically become protected, unless creditors object) is binding on all creditors, and no further debt recovery measures may be undertaken.
- 3.6 From the debtor's point of view, a protected trust deed provides a way of dealing with intractable debt problems without having to meet the formal criteria of apparent insolvency, and without the social stigma of bankruptcy. However, there is no formal discharge from protected trust deeds after three years (as there is with bankruptcy), and debtors do still lose their assets.
- 3.7 Although many debtors are still unaware of the possibility of entering into a trust deed, the number of protected trust deeds is currently increasing rapidly in Scotland. In 1994/95 there were just 424 protected trust deeds registered, while in 1999/2000, at 2,353, they surpassed debtor petitions for sequestration for the first time.

4 Practice issues identified

- 4.1 In the course of the research a number of important issues were identified.

Defining business-related bankruptcy

- 4.1.1 At present, bankruptcy statistics in Scotland do not distinguish between business-related and consumer bankruptcies even on the most basic level. While the most appropriate definition for business-related bankruptcy in the Scottish context is not immediately obvious, a number of options do exist, as summarised in table 1.

³ The diligence of poinding and warrant sale is to be abolished not later than 31st December 2002. A Working Group has been set up to identify an alternative diligence against moveable property and make recommendations to Parliament.

Table 1. Summary of approaches to defining business-related bankruptcy

Approach	Brief description	Comments
Association with trading as a business	Any evidence that the debtor has traded, or is trading, as a business at the time the debts were incurred	Limited in scope; will tend to overstate the number of business-related bankruptcies Easy to measure
Nature of debt	Examine the composition of the debts involved - take as business-related if more than a given proportion of debts are business debts	Better measure, but could be difficult to assess the composition of debts; would require some investigation of the debts
Cause of debt	Examine the circumstances giving rise to the debts to distinguish business-related causes from consumer-related causes, and the extent of debtor responsibility	Provides additional information about nature of the bankruptcy, in particular identifies extent of debtor responsibility - future policies may wish to tackle issues such as training in competencies to run a business, or to distinguish between “culpable” and “non-culpable” bankruptcies Difficult to measure. Requires significant, detailed investigation

Effectiveness of sequestration

- 4.2 From the creditors’ perspective, sequestration is not particularly effective; the rate of return is low, and in the majority of cases no payment is made to the creditors.

Impact

- 4.3 From the debtors’ perspective the impact of sequestration can be devastating, even though little or no funds are realised for the creditors. What few assets may exist are often taken up by the costs of the sequestration process itself, and it might be said that the only beneficiaries are the insolvency practitioners who are appointed as trustees. Where the sequestration has been invoked by the debtor him/herself, however, the impact is more one of bringing relief from the pressures of creditors, though there is much evidence to suggest that debtors do not necessarily understand the full implications of sequestration when they enter into it, and that by then it is too late to do anything about it.

Lack of information

- 4.4 Lack of information and understanding seems to be the norm; debtors report having no-one to turn to for objective advice when they get into financial difficulty; solicitors and accountants generally have only a limited knowledge of bankruptcy law, and those with specialist knowledge tend to charge high up-front fees for their services. Businesses in financial difficulty are unable to afford the advice offered. At the same time, it appears to be a characteristic of failing businesses or of people falling deeper into debt that they do not seek advice, and try to tackle the problem by working harder, or by trying to trade themselves out of difficulty. Ignorance of the process of sequestration and of its likely impact was therefore widespread amongst those interviewed, despite the good efforts of the Accountant in Bankruptcy in providing easy-to-read booklets summarising the sequestration process.

Alternatives to sequestration

- 4.5 There is no hard information about the number of bankruptcies that could have been avoided if impartial professional advice had been available earlier, but the indications of the scoping study suggest that it could be considerable. A number of factors do prevent such advice being sought, including an unwillingness to admit to oneself or to others that there are financial difficulties, and the lack of suitable sources of advice. It is clear, for example, that while the Local Enterprise Companies throughout Scotland can offer considerable advice and assistance to businesses at start-up and when they want to expand, there is significantly less specialist advice available to offer businesses in difficulty, or even a health-check for those that appear to be trading normally. It is also the case that anyone can start up their own business (and almost anyone can become a director of a limited company) without any training or qualification. This can mean that many business owners are ill-equipped to deal with financial difficulties when they occur.

Different views

- 4.6 In the process of sequestration, several different people are involved: the creditor(s); debtor; the debtor's family; the trustee; the debtor's advisors (if any). The interviews undertaken during the scoping study indicate a lack of effective communication between the parties: the creditors tend to view the debtors as people who won't, rather than can't, pay; the debtors view the creditors as unreasonable; the debtors view the trustee as working in isolation and not keeping the debtor informed; and both the debtor and creditor view the trustee as taking most of the realisable assets for their own fees. Those Insolvency Practitioners interviewed in the study also tend to have a limited view of the debtors - that they got themselves into the situation they are in and to some extent deserve all they get.
- 4.7 There is certainly considerable scope for better communication between the participants, and for better understanding of their respective views.

Impact of sequestration

- 4.8 Although it certainly provides relief to many debtors, sequestration often has a devastating effect on the debtor and his/her family. Few are prepared for the seriousness of the effects and most are ignorant of even the basics, such as what will happen to their house. More than this, many of the worst psychological effects of sequestration come not from the effects of the legislation but from other factors - the feeling of having control taken out of their hands, the association in people's minds that bankruptcy equates to dishonesty (a significant number of contracts of employment, for example, make bankruptcy grounds for dismissal, along with criminal activity), and the very clear message that bankruptcy equates to failure. Many of these negative feelings are fuelled by the trustees and by the creditors, and much could be done to make the experience of sequestration much less negative than it is.

Impact on business start-up

- 4.9 No evidence could be identified in the scoping study to suggest that the possibility of bankruptcy, or the procedures surrounding sequestration, have any impact on business start-up or growth. Only in the case of people who have been bankrupt was there any suggestion that the experience would deter them from taking risks in the future - again, largely because of the associations that go with bankruptcy, or of the experience of failing in business, rather than the process of sequestration itself.

5 Issues for a main study

- 5.1 The scoping study examined the potential content of a main study, the research methods which could be adopted and the feasibility of undertaking a study, in terms of costs, the benefits it would bring and the potential risks.
- 5.2 Overall, there is a clear need for a systematic study of business-related bankruptcy in Scotland, both to identify the numbers and characteristics of such bankruptcies each year (currently no reliable statistics are collected), and to examine how current legislation and practice works and how these might be changed to the overall benefit of business and the economy.
- 5.3 However, the scoping study has also highlighted the very considerable potential to help people in business avoid sequestration, by providing suitable help and advice at an early stage and by encouraging the use of other, less formal, methods of debt recovery and management. These would offer higher rates of return for creditors whilst permitting, at least in some cases, the debtors' businesses to continue trading, and would potentially be of lower cost than the formal processes of sequestration. For this reason, the recommendations from the scoping study include significant reference to the need for action research - pilot-scale projects to investigate and trial approaches aimed at preventing business-related bankruptcies. At present, the Scottish Executive continues to monitor and learn from pilot studies underway elsewhere in the UK.

- 5.4 The main issues identified in the scoping study, and which would impact on the design of a main study, include:
- the difficulty of defining business-related bankruptcy and distinguishing between business-related and consumer bankruptcies;
 - the potential importance of personal responsibility in business-related bankruptcies;
 - the impact of bankruptcy on the businesses affected, and how this could have been changed;
 - examining the relative effectiveness of sequestration against its objectives, and identifying potential alternatives;
 - examining the potential for preventing business-related bankruptcies, through the provision to businesses of better information, and through informal methods of debt recovery.
- 5.5 The driving force behind a main study would be to identify ways of helping the business start-up and survival rates in Scotland, and to encourage entrepreneurial activity in the business community:
- by reducing the likelihood of business failure and bankruptcy occurring;
 - by encouraging (genuine) business people who have gone bankrupt to recover quickly and to use their experience of failure to help build successful businesses;
 - by reducing the negative impact that the fear of bankruptcy may have on entrepreneurial activity.
- 5.6 In order to address these objectives and aims, a main study needs to focus on a range of issues. A study would need to:
- develop an understanding of the incidence and characteristics of all bankruptcies, and of how to distinguish between business-related and consumer-related bankruptcies;
 - identify how support could be provided more effectively at an early stage to businesses in difficulty, in order to reduce the incidence of business failure and the need for sequestration;
 - analyse business-related bankruptcies according to the causes that led to them;
 - establish baseline figures on the incidence of business-related bankruptcy, to enable monitoring of trends in the future;

- develop a better understanding of the pathways to bankruptcy in the business situation;
- examine the effectiveness of sequestration against its key objectives;
- identify whether there are alternatives to bankruptcy which could achieve the same overall objectives more effectively, perhaps for specific case types;
- assess the impact of bankruptcy on the individuals involved - the bankrupts themselves, their families, their creditors, professional practitioners, and the wider business community;
- identify ways in which bankruptcy law and practice could be altered, in order to result in better business sustainability, higher business start-up rates and a reduced negative impact on genuine business people;
- learn from the best practices in other jurisdictions, and identify the extent to which they could work in Scotland.

5.7 In order to focus on these issues, the research in a main study should gather a range of information about:

- sources of business support and advice;
- the incidence and characteristics of business-related bankruptcies;
- the effectiveness of sequestration and of alternatives to sequestration;
- the impact and effects of business-related bankruptcy;
- how current bankruptcy legislation works in practice, and potential changes to existing bankruptcy law.

5.8 In order to gather the information required by a main study, and to address its objectives, it is envisaged that such a study would comprise seven main strands:

- a literature review, based on, but not limited to, the list of relevant references provided in the scoping study's Second Strand Working Paper (LR);
- a statistical data collection exercise to collect objective data on the incidence and causes of business-related bankruptcy, and alternatives to it (SD);
- questionnaire-based surveys, involving entrepreneurs and key groups of individuals affected by, and working with, bankruptcy, trust deeds or diligence, to collect both qualitative and quantitative information on the causes, processes and implications of sequestration and associated measures (QS);

- interview-based research with a selection of questionnaire respondents, to provide more in-depth information (IR);
- case study-based research, following through a number of selected bankruptcies, involving interviews with all the key players involved – to provide a greater understanding of the processes involved in bankruptcy, of the differences of perception between different key players, and of the interactions between them (CS);
- review of sources of advice and support to businesses, and their applicability to businesses experiencing difficulty; assessment of their current services in relation to business needs and identification of potential development areas to serve business needs better (AS);
- an action research study, to examine potential alternatives to or diversions from the sequestration process (AR).

5.9 Table 2 illustrates how each of the suggested methodologies would contribute towards providing the information required by a main study.

Table 2. Contribution of different methodologies towards required information

Information required		Methodology (see codes above)
Business support and advice	Sources of information, advice and support	AS, QS, IR
	Methods for detecting businesses in difficulty	LR, AR
	Methods for encouraging businesses to seek support	LR, AR
	Effective ways for providing support to businesses in difficulty	LR, AR
Incidence and characteristics of business-related bankruptcies	Numbers of business-related bankruptcies	SD
	Causes and types of business-related bankruptcy	SD
	Outcomes for businesses involved in bankruptcy	SD
	Pathways to bankruptcy	SD, QS, IR, CS
Effectiveness of sequestration and of alternatives to sequestration	Effectiveness of sequestration in achieving its objectives	LR, SD, QS, IR, CS
	Relative effects of sequestration and alternatives	QS, IR
	Views on sequestration and alternatives	QS, IR
	Other potential options	QS, IR, AR

Table 2. Contribution of different methodologies towards required information, continued

	Information required	Methodology (see codes above)
Impact and effects of bankruptcy	Impact on individuals: the debtor, the debtor's family, creditors, professionals	QS, IR,
	Impact on business start-up, growth, entrepreneurial activity	QS, IR,
	Secondary effects of bankruptcy	QS, IR
	Different perceptions of the different parties involved	QS, IR, CS
Experience of current legislation, potential for change	Options for reducing the negative impact of bankruptcy on business start-up and entrepreneurial activity	LR, QS, IR
	Options for reducing the negative impact of experiencing business failure	AR
	Options for increasing business survival rates	AR

5.10 Suggestions for possible action research projects have emerged from the scoping study, including:

- **well business clinic** - a source of information and advice to be offered to businesses trading normally, or those in some trouble at an early stage - often before the business itself knows it is in trouble. Such a clinic could offer a free check-up and diagnostic information on businesses, and sound professional advice for those in, or heading for, trouble.
- **key performance indicators** - publication of a set of key performance indicators which might help to highlight to businesses that they may be heading for trouble;
- **debtline** - an anonymous telephone helpline to provide information and advice to businesses in difficulty, to offer professional advice, and encourage management action to be taken on debt before the burden becomes insuperable;
- **intensive care unit** – aimed at rescuing businesses that are in severe difficulty and where the owner, partner or director is heading for sequestration. This service could offer an independent assessment of the viability of a business and – if considered to be worth rescuing – provision of the support and resources required to attempt rescue;
- **recovery and rehabilitation** – aimed at assisting bankrupt people return to business. This service would include finding practical ways of tackling the barriers bankrupt people encounter, as well as providing the advice and support they need.

5.11 All of the research methods proposed for a main study present some practical difficulties, but analysis of these suggests they are not insurmountable.

6 Conclusions and Recommendations

6.1 The scoping study has failed to find any clear evidence that bankruptcy law itself is responsible for deterring potential entrepreneurs from starting up in business, though it may act to dissuade or prevent people from going back into business following sequestration. However, it does seem clear that a real issue exists around the provision of support to business people who are running into difficulties. Scottish Executive policy is to focus on business creation, survivability and growth but there appears to be limited public assistance available to businesses in difficulty. The support which is available is frequently inappropriate, incompetent, or too expensive to be accessible. Consequently, many business people do not receive the information and advice that might enable them to turn their business around, overcome their debt problems, and avoid sequestration.

6.2 While the experience of sequestration may serve to deter people from setting up another business, there is little doubt that the experience of failing in business, and building up intractable debt problems, is also a very significant deterrent to further enterprise in many cases. The impact of providing effective business support would therefore go beyond avoiding bankruptcy itself, and would include reducing or preventing the negative impact of business failure itself.

6.3 Against this background, a study of business-related bankruptcy is clearly needed, firstly to provide the baseline statistics required, secondly to provide a better understanding of its causes, and thirdly to establish how the negative impact of business-related bankruptcy could best be ameliorated, or bankruptcy itself avoided.

6.4 Table 3 below provides a summary of the feasibility issues for a main study.

Table 3. Summary of feasibility issues

Component	Feasibility issues	Comments
Literature review	No significant issues	Useful – for background and comparative information
Analysis of Register of Insolvencies	Incomplete data, limited detail	Essential – for baseline data
Analysis of bankruptcy files at office of the AiB	Very time-consuming, data likely to be inconclusive in some cases	Desirable – but the research time and costs may outweigh the benefit

Table 3. Summary of feasibility issues, continued

Component	Feasibility issues	Comments
In-depth investigation of individual bankruptcies	<p>Possible difficulty in:</p> <ul style="list-style-type: none"> - finding researchers with the right combination of skills to do the research - finding debtors willing to take part - defining criteria for classifying cases - obtaining sufficient in-depth, objective information, e.g. in the absence of business books 	<p>Essential - for obtaining the data required to identify causes of business bankruptcy, the outcome of the bankruptcy for the business, and the viability of the business at the time of sequestration</p> <p>Essential - for the development of an objective statistical monitoring system for future use</p>
Questionnaire survey of debtors	<p>Possible difficulty in:</p> <ul style="list-style-type: none"> - making contact with selected sample - obtaining an adequate response rate 	Useful - for obtaining statistical data on the experiences and views of debtors
Questionnaire survey of creditors/businesses	Would require an appropriately stratified sample	Useful - for obtaining statistical data on the experiences and views of creditors and businesses in general

Table 3. Summary of feasibility issues, continued

Component	Feasibility issues	Comments
Questionnaire survey of insolvency practitioners	Possible inability or unwillingness to provide detailed information	Useful - for obtaining statistical data on the experiences and views of insolvency practitioners
Interviews	Possible difficulty in finding debtors willing to participate	Useful - for obtaining in-depth data on key players' experiences and views
Case studies	Possible difficulty in finding debtors willing to participate, and in obtaining the co-operation of creditors, trustees, etc	Useful - for obtaining data to reconcile the different perspectives of different key players
Evaluation of sources of advice and support	None identified	Essential for identifying how steps can be taken to develop diversion strategies from bankruptcy
Action research	Requirement for the project to be very professionally organised, staffed and publicised	Essential - to establish clearly the benefits of providing appropriate support to businesses in difficulty

6.5 Specific recommendations are:

- A statistical analysis of the Register of Insolvencies should be undertaken.
- Statistical data collection on business-related bankruptcies should commence, through additions being made to the Supplementary Questionnaire. The amended version should then be issued to all insolvency practitioners, along with a letter of introduction and guidelines.
- A pilot should be started for undertaking additional research with recently bankrupt people, including an investigation of their business books. Initially,

insolvency practitioners, and others, should be approached with a view to forming a working party to produce defining criteria for the investigation and data collection. With additional regard to other aspects of the research with recently bankrupt people, it is recommended that some of these bankruptcies be used as the basis of case studies, involving interviews with their creditors, trustees, and other relevant professionals, as well as the debtor.

- A systematic review of services to businesses in difficulty should be undertaken, including an evaluation of how relevant they are to the needs of businesses.
- The possibility of developing one or more action research projects providing support to businesses in difficulty should be examined, these discussions to take place with policy makers, the enterprise network, business-related organisations and potential funders.

1 Introduction

1.1 Background

- 1.1.1 Amid concern about the relatively low business birth-rate in Scotland, as compared with the rest of the UK, in June 1998 the late Donald Dewar, then Scottish Secretary, announced a target of 100,000 new businesses (start-ups, less closures) to be set up in Scotland over the following ten years. At the same time new targets to reduce the number of business failures were also set, and a number of measures announced, including the formation of a new Business Growth Unit, and a review of business support schemes. However recent research has shown that these original targets were inappropriate and new measures have been introduced to address the business birth rate in Scotland.
- 1.1.2 Against this background, over recent years there has been an increasing awareness that one aspect of Scottish culture that may be discouraging entrepreneurial activity is the “stigma attached to business failure”⁴. It has been suggested that the Scottish parliament should “applaud business success and be less critical of business failure”⁵, and should encourage “entrepreneurs who have experienced genuine failure to get back into risk-taking”⁶. In December 1999, the Entrepreneurial Exchange published a paper proposing that “rather than punish and discourage those who fail [in business] we must encourage them to try again”.⁷
- 1.1.3 A small proportion of business failures result in the personal bankruptcy of the entrepreneur, working as a sole trader or partnership, or having given personal guarantees on loans made to a limited company. The Entrepreneurial Exchange views existing bankruptcy law as effectively punishing those who fail in business, and therefore feels that it acts as a barrier to enterprise, and suggests that there should be significant reforms to the law. Meanwhile, in England and Wales, an awareness of the need to reduce the financial and social consequences of those business failures which leads to bankruptcy has also been developing. In March 2000, the Department of Trade and Industry’s Insolvency Service published a consultation document suggesting possible reforms to the law.⁸
- 1.1.4 In June 2000 the Scottish Executive Justice Department commissioned the first part of a study to look into business-related bankruptcies in Scotland.

1.2 Requirements

- 1.2.1 The first part of the study into business-related bankruptcies was a scoping study, primarily aimed at informing the design of a full study which is being considered for 2002/03. As such, it has been concerned with examining the information currently available about business-related bankruptcies in Scotland and clarifying a number of definitional issues. The study has also sought to identify issues that a main study should address, and to develop an appropriate set of research methodologies for examining the causes and impact of business-related bankruptcies in a main study.

⁴ Inquiry 2000 – Seven Years on from the Business Birth Rate Inquiry, April 2000

⁵ Pathfinders to the Parliament – A Business Agenda for the Scottish Parliament, The Scottish Office, March 1999, Small Business Chapter

⁶ Pathfinders to the Parliament – A Business Agenda for the Scottish Parliament, The Scottish Office, March 1999, Executive Summary

⁷ In Aid of Enterprise – Reform of Scotland’s Bankruptcy Laws, Entrepreneurial Exchange, December 1999

⁸ Bankruptcy – A Fresh Start, Department of Trade and Industry, March, 2000

1.3 Approach

- 1.3.1 The approach taken during the scoping study included 4 main elements.
- 1.3.2 Firstly, a literature search was undertaken to establish the range of literature available covering issues relating to insolvency in general, and business-related bankruptcy in particular, both in Scotland and in other jurisdictions.
- 1.3.3 Secondly, an analysis was undertaken of existing data sources that provide information about bankruptcies in Scotland, in order to evaluate the extent to which they enable the identification of business-related bankruptcies.
- 1.3.4 Thirdly, field research was undertaken, including over 20 telephone interviews and 43 in-depth face-to-face interviews, with a wide range of people affected by bankruptcy either personally, or in a professional capacity. Interviews were included with debtors themselves, entrepreneurs, creditors, insolvency practitioners, solicitors, court staff, a sheriff officer, money advisors, business advisors and representatives from business-related organisations and from equality organisations. The objectives of the interviews were to gather information about bankruptcy, including the causes, process and impact of bankruptcy, to explore the views and experiences of those interviewed, and to identify potentially relevant issues. The interviews were followed up by two workshops – one for those with personal experience of bankruptcy and one for those who have a professional involvement – with a view to feeding back the main findings of the scoping study research, validating these findings, and identifying any gaps.
- 1.3.5 Finally, the scoping study involved an assessment of potential research methodologies and approaches for use in a main study, including examination of their feasibility, and the potential risks and benefits. This also included analysis of the timescales required.
- 1.3.6 Findings from all four parts of the scoping study are summarised in the sections that follow.

2 Bankruptcy and Sequestration

2.1 Introduction

- 2.1.1 In Scotland, there are two strands to insolvency law, with the insolvency of limited companies being covered by the Insolvency Act 1986, and that of individuals, partnerships and other unincorporated bodies being covered by the Bankruptcy (Scotland) Act 1985, as amended in 1993. While limited companies are liable to liquidation, receivership or administration if they become insolvent, individuals are liable to bankruptcy, which involves sequestration – that is, the debtor’s estate passes to a trustee, for distribution to the creditors.
- 2.1.2 Bankruptcy legislation was first introduced in Scotland in 1621, with sequestration appearing in the legislation in 1772, though at that time it applied only to debtors who were in trade. It was not until the mid-19th Century that bankruptcy law was extended to cover all debtors. The new law made provision for a debtor to obtain a discharge from debts, even if creditors had not been paid in full, and also abolished the penalty of imprisonment for debt. The role of the Accountant in Bankruptcy was also created at this time, to provide impartial supervision of the sequestration process. Current bankruptcy law was introduced by the Bankruptcy (Scotland) Act 1985, which was amended in 1993; however, there are still a few bankruptcies being administered under the Bankruptcy (Scotland) Act 1913, which preceded the current legislation.
- 2.1.3 Bankruptcy law in Scotland does not distinguish between individuals on the basis of the cause of their bankruptcy, or on whether they were trading as a business at the time of, or in the period leading up to, their bankruptcy. Likewise, the statistics currently available about bankruptcy in Scotland do not distinguish between those involving business debts as compared to those involving only consumer debts⁹. However, the statistics for Scotland do show that the number of sequestrations has been increasing consistently, though not dramatically, over recent years, with 2,340 sequestrations in the year ending April 1995, rising to 3,185 by the year ending April 2000¹⁰.

2.2 The objectives of sequestration

2.2.1 Current bankruptcy law has three main objectives:

- firstly, the law serves the economy and society as a whole, ensuring a climate in which debts are generally paid, by acting as a deterrent to non-payment of debts;
- secondly, the law provides for the repayment of debts to creditors: in sequestration the debtor’s assets pass to the trustee, whose duty it is to realise them and distribute them equitably to all creditors;
- thirdly, bankruptcy law provides relief to debtors unable to pay their debts: with sequestration, creditors can no longer exercise debt recovery procedures against

⁹ A number of sources of statistics on bankruptcies in Scotland exist, including those published by the Accountant in Bankruptcy, the Department of Trade and Industry (DTI), and Dun & Bradstreet, a commercial business information company. The Scoping Study has found that the most reliable and comprehensive source is the Accountant in Bankruptcy.

¹⁰ Annual Report, 1999/2000, The Accountant in Bankruptcy, p.23

the debtor, whether formal or informal, and the debtor is discharged after three years irrespective of whether the debts have been paid¹¹.

2.2.2 In contrast with some other jurisdictions, Scottish bankruptcy law does not place emphasis on protecting the business, the business' employees, or the debtor's family, and may be considered to be more creditor-orientated than much bankruptcy law in continental Europe and the USA. Bankruptcy law does not currently provide for an independent assessment of the viability of a business, or for attempted business rescue, prior to sequestration. This is an important point, to which we return later in the report.

2.3 The process of sequestration

2.3.1 The formal process of sequestration begins with the presentation of a petition for sequestration at the debtor's local Sheriff Court, or at the Court of Session. A petition for sequestration may be presented either by the debtor him/herself or by a creditor, though specific criteria must be met in both cases. Firstly, the debts must amount to £1,500 or more, and generally the debtor must also be "apparently insolvent", a term which has a strict legal meaning.

2.3.2 There are three main ways in which a debtor's "apparent insolvency" can be established. These are through:

- a "statutory demand" having been served on the debtor, and payment not having been made within the 21 day notice period, or the debt having been disputed;
- an ordinary court action having resulted in the award of a decree, a "charge for payment" having been served, and payment not having been made within the 14 day notice period;
- a "summary warrant" having been granted in relation to unpaid rates or taxes, and the debtor's goods having been "pounded".

2.3.3 Petitions by debtors are normally awarded immediately, on the same day that they are applied for. Petitions by creditors, in contrast, take at least 14 days. Following a petition by a creditor, a Warrant to Cite is issued by the court, which allows the debtor 14 days in which to take action to prevent the sequestration being awarded. Sequestration is a summary proceeding, and if the sequestration cannot be dismissed – due to payment having been made – it will be awarded at the hearing. However, some sheriffs are willing to continue consideration of the motion, perhaps if the debtor produces a cheque at the hearing, or states that s/he will be able to pay the amount in full within the next few weeks. In this respect there is some variability in practice between sheriffs.

2.3.4 Any petition for sequestration may include nomination of an interim trustee, but if an interim trustee is not nominated this role will go to the Accountant in Bankruptcy (a

¹¹ The trustee can ask for a deferment of discharge on specified grounds, including if the debtor has failed to co-operate or is suspected of committing offences.

statutory official, appointed to provide impartial supervision of the sequestration process¹²). The main role of the interim trustee is to investigate and preserve the debtor's estate, including investigating the reasons for the debtor's insolvency, and the extent of both their assets and liabilities. The interim trustee may also call a statutory meeting of creditors, although such meetings are frequently considered unnecessary in cases where there is little or nothing by way of assets.

- 2.3.5 At the statutory meeting of creditors a permanent trustee may be elected, and in these cases creditors may also elect commissioners from amongst their number, to supervise the work of the permanent trustee. If a permanent trustee is not elected, the interim trustee will apply to become permanent trustee through submission of an Act and Warrant to the court. The main role of the permanent trustee is to manage and realise the debtor's estate and distribute it amongst the creditors according to their relative entitlements.
- 2.3.6 Once awarded, sequestration can be recalled. However the debtor must pay all the fees owing, including the trustee's fees and court fees, as well as their own legal fees. They must also pay all their debts in full, unless creditors are willing to make a written statement that there is no current problem with the debtor's account. Recall of sequestration must take place in the Court of Session, rather than a sheriff court, and is relatively time-consuming and costly.

2.4 Pathways to sequestration

- 2.4.1 For creditors, a number of alternatives exist for attempting the recovery of debts. In some cases these may lead to sequestration, though in practical terms, sequestration of the debtor is rarely of benefit to the creditor. For the purposes of recovering moneys due, other forms of debt recovery are generally more effective, and sequestration is often a last resort, or if sought earlier, may be an action designed to tackle a debtor who won't, rather than can't, pay. There are therefore numerous pathways leading to sequestration:
- creditors may employ informal debt recovery procedures, including issuing final demands and letters, and making telephone calls and face-to-face visits;
 - creditors may attempt to assist debtors, through use of intensive care procedures, and/or be willing to come to an arrangement for payment of the debt over a period of time;
 - creditors may take formal action to prove the debt, including applying to the sheriff court for a decree or a summary warrant (if a local authority or government department), or issuing a statutory demand;
 - government creditors may follow up a summary warrant by poinding, in order to establish apparent insolvency, or by other forms of diligence; other creditors may follow up a court action by issuing a charge for payment (thus establishing apparent insolvency), and doing diligence;

¹² See the Glossary of Terms in Annex A.

- Having proved the debt, a creditor may attempt a number of different forms of diligence - including inhibition, earnings arrestment, ordinary arrestment, poinding and warrant sale¹³;
- Having established the debtor's apparent insolvency, and either having already attempted to do diligence, or instead of doing it, the creditor may petition for the debtor's sequestration;
- apparent insolvency having been established (as indicated above), the debtor may petition for his/her own sequestration in order to seek relief from further debt recovery procedures.

2.4.2 When debts are not paid, creditors appear to operate on the basis that the debtor "won't pay" rather than "can't pay", and that applying continued pressure will eventually force the debtor into payment. Thus creditors tend to work their way through a range of debt recovery procedures, as a step-by-step process, at each stage hoping that the pressure being applied will convince the debtor to pay. There is much evidence that these measures are effective in many instances. Many creditors emphasise the importance of debtors communicating and co-operating with them, and state that whatever stage has been reached in debt-recovery procedures, they are always happy to consider a realistic arrangement for payment of the debt.

2.4.3 The debt-recovery procedures chosen by a creditor, and their route through diligence and potentially to sequestration, are based on a number of considerations. These include:

- the size of the debt;
- the debtor's debt history;
- the extent of the debtor's assets and/or income;
- what is known about the debtor (in terms of assets, employment, bank details, etc);
- whether the debt is likely to be disputed;
- the likely cost of the action.

2.4.4 Some creditors have a policy of avoiding warrant sales, and sometimes even poinding, but in the main the route creditors take is based on clear commercial considerations.

2.4.5 For many creditors, petitioning for the sequestration of a debtor is considered to be a last resort, only to be turned to when informal debt-recovery procedures and doing diligence have failed. However, there are some creditors who use sequestration quite early on in their debt-recovery procedures, and do not attempt diligence before turning

¹³ The diligence of poinding and warrant sale is to be abolished not later than 31st December 2002. A Working Group has been set up to identify an alternative diligence against moveable property and make recommendations to Parliament.

to sequestration. In either case, petitioning for sequestration is generally just one more step in the process of putting pressure on a debtor in order to force payment. The creditor's primary aim rarely appears to be to sequester the debtor as such, rather it is to push the debtor into payment by the threat of sequestration.

- 2.4.6 Nevertheless, creditors may have other motives when petitioning for a debtor's sequestration. Creditors may use sequestration as a warning to other debtors; and in some cases a creditor may sequester as a deliberate act of punishment or retribution, if they feel a debtor has acted dishonestly, or has been deceptive. Government departments, such as the Inland Revenue and Customs & Excise, very clearly use sequestration in order to put a debtor out of business, and prevent the build-up of any further debts.
- 2.4.7 Creditors claim that the decision to petition for the sequestration of a debtor is generally made on a commercial basis, taking into consideration such issues as the cost of sequestration, the value of the debt and the likely value of the debtor's assets. Yet, the small proportion of cases in which dividends are paid out to creditors, in sequestration, shows that it is rarely a successful mechanism for recovering debts. Statistics from the Accountant in Bankruptcy¹⁴ show that during 1999/2000 a dividend was paid to preferred creditors only in 124 (4% of) cases, with preferred creditors being paid in full and a dividend also being paid to ordinary creditors in a further 261 (9% of) cases. More than half of the ordinary creditors to whom a dividend was paid received less than 25p in the pound, and the average dividend paid to ordinary creditors who did receive one was 25.5p in the pound. 51 ordinary creditors (20% of those who received a dividend) received full repayment of their debt – full repayment thus being received by ordinary creditors in just 2% of sequestrations.
- 2.4.8 Given these figures, it is perhaps not surprising that some creditors deliberately avoid any action which would make a debtor apparently insolvent, since this would allow the debtor to petition for his/her own sequestration. Such creditors believe that they have a better chance of recovering their debt through informal debt recovery procedures, and see sequestration as protecting the debtor from further attempts at debt recovery. In these cases, the debtor is denied the relief of sequestration, and may be put under repeated, and even aggressive, pressure by creditors.
- 2.4.9 Notably, although the overall number of sequestrations has increased over recent years, the number of creditor petitions in 1999/2000 (at 1,140) was actually slightly lower than in 1994/95 (at 1,163). The increase in sequestrations is therefore entirely attributable to an increase in debtor petitions, which have nearly doubled over the same period, rising from 1,171 in 1994/95 to 2,026 in 1999/2000¹⁵. Evidently, while there is little change in creditors' use of sequestration, there is an increasing trend towards debtors using sequestration to obtain relief from debt.

2.5 An alternative to sequestration – protected trust deeds

- 2.5.1 There is little doubt that, for many debtors, sequestration provides a way out of intractable debt problems and, as such, is a source of relief. For some such debtors

¹⁴ Annual Report, 1999/2000, The Accountant in Bankruptcy, p.14-15

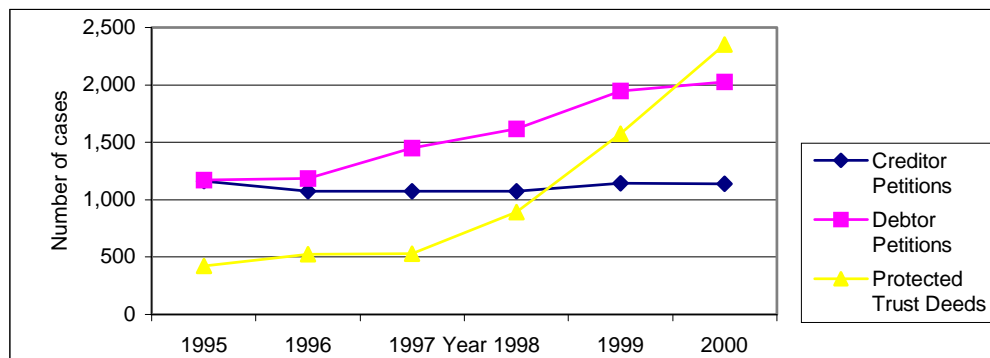
¹⁵ Annual Report, 1999/2000, The Accountant in Bankruptcy, p.23

however, an alternative does exist to petitioning for their own sequestration, this being to enter voluntarily into a trust deed.

2.5.2 A trust deed is a formal, legally binding contract between a trustee and a debtor, entered into voluntarily, under which the trustee administers the debtor's assets for the benefit of his creditors. Provided it meets certain conditions a trust deed automatically becomes protected if notice of it is served on all creditors, unless the majority of the creditors, or one third of creditors (by value of the debt), object in writing. Once the trust deed becomes protected it is binding on all creditors, and no further debt recovery measures may be undertaken.

2.5.3 From the debtor's point of view a protected trust deed provides a way of dealing with intractable debt problems without having to meet the formal criteria of apparent insolvency, and without the social stigma of bankruptcy. Signing a trust deed has the advantage of being a private and voluntary arrangement, which does not involve the courts, formal bankruptcy, or restrictions on obtaining credit. However, there is no formal discharge from protected trust deeds after three years, and debtors do still lose their assets - one of the conditions for registration as protected is that the trust deed should convey all the debtor's assets to the trustee, for distribution to creditors.

Chart 1 – Debtor & creditor petitions for sequestration and protected trust deeds¹⁶



2.5.4 Although many debtors are still unaware of the possibility of entering into a trust deed, the number of protected trust deeds is currently increasing rapidly in Scotland. In 1994/95 there were just 424 protected trust deeds registered, while in 1999/2000, at 2,353, they surpassed debtor petitions for sequestration for the first time. This rise has prompted some concern that insolvency practitioners may be encouraging the use of protected trust deeds even in cases where there is little benefit to creditors, as long as their own fees and expenses are paid. Some creditors claim that protected trust deeds are very slow to come to completion, and there is also evidence that dividends are often very low – indeed, there is concern that protected trust deeds may be entered into even where the debtor has no assets or income. However, very little is currently known about how protected trust deeds are being administered, or even in what circumstances debtors are entering into them, rather than petitioning for sequestration.

¹⁶ Annual Report, 1999/2000, The Accountant in Bankruptcy, p.23

2.6 The debtor's experience of sequestration

- 2.6.1 Although there may be an element of relief when sequestration occurs, for many debtors this is combined with a range of other emotions, including anger, frustration, a sense of failure, a loss of self-esteem, and a sense of powerlessness. Many bankrupt people feel that they were badly treated by their creditors, who did little to help them through their debt problems, or who petitioned for their sequestration when they could have traded through their problems. Others have a strong sense that bankruptcy shows they have failed, both as a business person and as a manager of their own financial affairs, while some resent the loss of control over their own affairs. In addition, many debtors are very conscious of the stigma that attaches to bankruptcy, often feeling that other people frequently associate bankruptcy with dishonesty.
- 2.6.2 The stigma attached to bankruptcy appears to be supported by many of the restrictions placed on bankrupt people. While bankrupt, a person cannot act as an MP, a local councillor or even be on a school board, some professional people are unable to practice while bankrupt and others lose their licence or certificate of professional competence as a result of bankruptcy. In addition, the Directors Disqualification Act does not allow a bankrupt person to be the director of a limited company, although directors of companies that go into liquidation are not generally disqualified. Even application forms for a range of jobs, including nursing and working as a prison officer, ask if the applicant is bankrupt, while some contracts of employment include bankruptcy as a reason for dismissal.
- 2.6.3 Once sequestered, many debtors appear to feel that they are given little information about bankruptcy, and seem to have a very incomplete understanding of bankruptcy law, or of their own rights and responsibilities. Debtors may feel that there is nobody to whom they can turn for help or advice as they go through bankruptcy, and since many solicitors and accountants are unfamiliar with bankruptcy law even these advisers are often ill-placed to advise them. Most debtors have little contact with their trustee, and in some cases feel that they have been unreasonably or badly treated by the trustee, or even that s/he has bullied or hounded them. Debtors may feel that, having taken over their affairs, the trustee has not handled them effectively, perhaps that the trustee has done too little to recover money owed to them by their own debtors, or has sold off assets for significantly less than their market value.
- 2.6.4 For many debtors their house is their main asset, and trustees are therefore obliged to realise the value of their equity in the house, sometimes through agreeing a voluntary sale with the debtor and his/her spouse, and sometimes by going to court to force eviction. Alternatively, agreement may be reached whereby the debtor's spouse, or other family members, are able to buy out the trustee's interest in the house. Although a bankrupt person is discharged after three years, the trustee is not discharged until all the debtor's assets have been realised, and realisation of the house as an asset may remain outstanding well beyond the debtor's discharge. This can result in the debtor and his/her family living with uncertainty and insecurity about their home for several years. At present, no statistics are available about how frequently debtors lose their homes as a result of sequestration.

2.7 Concerns about trustees

- 2.7.1 Amongst both creditors and debtors involved in the scoping study there is some concern about the extent of accountability of insolvency practitioners working as trustees, and as agents of the Accountant in Bankruptcy.
- 2.7.2 The creditors' concerns include the suggestion that trustees can build up fees without undertaking sufficient investigation of debtors, and that trustees' work proceeds at too slow a pace, being "fee driven", rather than being driven by the objective of getting the best for creditors. Some creditors also feel that there is insufficient communication between themselves and trustees, with trustees failing to keep them informed about progress in the realisation of assets.
- 2.7.3 The debtors share some of these concerns, and feel there should be more regulation of trustees, and that trustees should be obliged to inform the debtor how much they have realised from his/her assets, paid to creditors, and taken in fees.
- 2.7.4 One of the roles of the interim trustee is to "ascertain the reasons for the debtor's insolvency and the circumstances surrounding it"¹⁷. However, the level of fees payable to trustees, and especially to agents of the Accountant in Bankruptcy, means that the time they are able to devote to such investigation is restricted, and often minimal. If a business is involved, the trustee may not even look at the business's books, and in practice trustees can frequently undertake little or no investigation into the causes of insolvency, with their assessment at best being superficial, cursory and subjective. Even if they suspect wrongdoing, trustees rarely seem to be able to make a thorough investigation of the circumstances surrounding bankruptcy. Occasionally a large creditor may finance such investigation if they feel a substantial amount of money may be recovered, but this is dependent on a cost-benefit analysis. Where the Accountant in Bankruptcy is trustee, there appears to have been a shift of emphasis away from thorough investigation in recent years, in order to avoid unnecessary expenditure of public funds.
- 2.7.5 In some cases, trustees may allow a business to continue trading for a while following sequestration, thereby taking on personal liability for the business, in all aspects, including financial, health & safety and employment. The trustee will usually have to request that the main creditor fund the continued trading. This generally appears to occur with particular types of business – such as hotels and pubs – because the assets are likely to be worth considerably more if the business is sold as a going concern than if closed down. Currently no statistics are available to provide more information about the frequency, circumstances, or success of this approach.

2.8 The effectiveness of sequestration

- 2.8.1 The effectiveness of sequestration is best viewed against the objectives of the process.
- 2.8.2 Since one aim of bankruptcy legislation is to ensure that debts are generally repaid, it is clear that the legislation is producing mixed results. While the majority of debts are

¹⁷ Notes for Guidance of Interim Trustees, Permanent Trustees and Agents, The Accountant in Bankruptcy, 2.2.4

undoubtedly repaid, there are nevertheless increasing debt problems in society, and the demand for the debt counselling provided by Citizens Advice Bureaux, amongst others, is clearly increasing. These changes cannot be blamed primarily on bankruptcy legislation, and indeed they may better be blamed on the ease with which credit is now obtainable. However, bankruptcy legislation is evidently not acting as an effective deterrent, particularly as regards consumer debt. In addition, there is some argument for suggesting that, in cases where consumer debtors have neither assets nor income, existing bankruptcy law is largely inappropriate for the relief of their debts, and that this could more effectively be dealt with by a simpler, less formal, and less expensive alternative.

- 2.8.3 The second aim of bankruptcy legislation – to provide for the recovery of debts by creditors – is again achieving mixed success. Undoubtedly, the threat of bankruptcy, in the form of a creditor petitioning for sequestration, does “force the hand” of many debtors who are able to pay the debt off, and hence have the sequestration dismissed. Around half of creditor petitions are dismissed as a result of the debt having been paid¹⁸. However, in cases where the sequestration goes ahead, the return to creditors is generally extremely low. The actual sequestration of a debtor is frequently of little or no benefit to his/her creditors.
- 2.8.4 The third aim of bankruptcy legislation – to provide relief to debtors with intractable debt problems – is frequently achieved. Many people who have been sequestrated experience a clear sense of relief when this occurs, having been living under enormous pressure from their debt problems. However, the dependence of sequestration on apparent insolvency, which means that sequestration does not rely on either practical insolvency (inability to pay debts as they fall due) or absolute insolvency (having debts of a value greater than assets), can result in apparent anomalies.
- 2.8.5 On the one hand, although a debtor is practically insolvent, s/he may be unable to obtain the relief of sequestration, since no creditor has taken action which results in his/her apparent insolvency. This situation principally affects consumer debtors, who may be unable to obtain relief from repeated, aggressive debt-recovery procedures.
- 2.8.6 On the other hand, a debtor may be apparently insolvent, although not absolutely insolvent, and in some cases not even practically insolvent. This situation principally affects debtors running a business, who may not have any significant debt problems, or may believe that they can cope with these problems and trade through them, but are being prevented from doing so by a creditor petitioning for their sequestration.
- 2.8.7 In some such cases failure to repay the debt prior to award of the sequestration may be the result of a simple mistake, or a failure in service of the papers (such as the papers being served on a third party, who fails to pass them to the debtor). In other cases the debtor’s business, although profitable, may have been experiencing cash flow problems which prevent immediate payment of the debt, and due to the summary nature of bankruptcy proceedings, result in the award of sequestration. Given that sequestration itself rarely results in creditors receiving full payment of outstanding debts, it is unlikely that in these cases the sequestration benefits the creditors. Indeed,

¹⁸ Estimating from Civil Judicial Statistics, 1999 and the Accountant in Bankruptcy’s Annual Report, 1999/2000, in 1999 52% of creditor petitions were dismissed.

had the debtor been given the opportunity to continue trading, a far higher level of payment to the creditors may have eventually been achieved.

2.9 Potential for rescuing businesses in difficulty

- 2.9.1 The research undertaken in the scoping study has suggested a range of causes of business failure, leading to bankruptcy. In many cases the business difficulties appear to result from a lack of business expertise, in some cases combined with the owner being responsible for running all aspects of the business, leading to problems such as a lack of adequate financial control, and the build up of debt. In other cases the business may be under-funded, a lack of adequate working capital resulting in the business being unable to survive bad debts, and cash flow being hit very hard by late payments. Even for successful businesses, market changes such as a much larger competitor opening up nearby or the loss of a main customer, may result in a dramatic fall in sales and a build up of debt, which cannot be survived unless the business is able to make significant changes.
- 2.9.2 The real need in all these circumstances is for change, perhaps a dramatic change in direction or product in order to cope with market changes, or changes to the management, organisation, staffing or funding of the business. Yet the response many business people make is simply to work harder, or to take a "head-in-the-sand" approach, in the hope that the problem will resolve itself.
- 2.9.3 The research has shown a clear lack of support for businesses experiencing these types of difficulty, and in need of assistance in making the necessary changes. Local enterprise companies concentrate on business start-up, information provision and growth and while they are concerned with business survivability there is inconsistent practical assistance for businesses in difficulty. Money advisors (for instance with Citizens Advice Bureaux) deal mainly with consumer debt, and generally do not have the expertise to assist effectively with business debt. Even many accountants and solicitors, the normal business advisers, are unable to provide the assistance needed by a business in difficulty. Appropriate assistance is available from specialists, such as business recovery professionals or insolvency practitioners, yet many business people do not know this, or find the high up-front fees charged prohibitive.
- 2.9.4 This evidence would suggest that there could be real benefits to be gained by ensuring that business people seek assistance when encountering difficulties, and that they have ready access to professionals able to give the specialist advice and support required. It seems possible that in many cases this type of intervention could result in the business being turned around, sequestration being avoided, and hence avoidance of further debt, and repayment over time of existing debt.

2.10 The impact of bankruptcy law on enterprise

- 2.10.1 In assessing the impact of bankruptcy law on enterprise, a number of different strands need to be considered.
- 2.10.2 Firstly, there is the issue of whether bankruptcy law is having an adverse effect on the propensity for potential entrepreneurs to start up in business. The scoping study has

failed to find any such evidence; rather it would appear that, when starting in business, the possibility of future bankruptcy figures little in entrepreneurs' thoughts.

- 2.10.3 Secondly, there is the issue of whether bankruptcy law allows the sequestration of people who are running viable businesses, thus putting them out of business unnecessarily. Potentially, it is clear that this is the case, yet statistics do not exist to show how frequently it occurs.
- 2.10.4 Thirdly, there is the question of whether bankruptcy law actually prevents people from going back into business, or makes it difficult for them to do so. Bankruptcy law itself does not directly seek to prevent bankrupt people from being in business, though other legislation does prevent them from being the director or manager of a limited company. In practice, many debtors remain in business, or go back into business while bankrupt, in some cases simply continuing work in a self-employed capacity, in others working for a limited company set up by another member of their family. Many debtors have little choice about going back into business, since it is the only way they have of earning a living.
- 2.10.5 Finally, there is the issue of whether bankruptcy law treats debtors so harshly that they may be dissuaded from any further attempts at running their own business. Certainly for some people, the experience of mounting debt problems and failure in business in itself puts them off wanting to go back into business. For others however, this is felt to have been a learning experience, and they believe they would be more likely to make a success of running their own business a second time around. The research undertaken in the scoping study suggests that, at three years, the period of undischarged bankruptcy may be unnecessarily long, and includes a punitive element. Under current bankruptcy law a bankrupt person loses all their assets including their home, however much money they had put into the business. It is also an offence for a bankrupt person to obtain credit of £250 or more, unless they have informed the creditor of their status in writing. However, the research has not clearly shown the extent to which any of these aspects of bankruptcy act to dissuade or prevent people from going back into business.
- 2.10.6 Consideration of the impact of bankruptcy suggests that it is not necessarily bankruptcy law itself which causes the difficulties experienced by people who are bankrupt, rather many of these difficulties and restrictions of opportunity are caused by attitudes, the prevailing culture and by other legislation. For instance, difficulties in obtaining credit while bankrupt, and after bankruptcy, cannot be attributed to bankruptcy law alone, but also to the attitudes of lenders and credit reference agencies. Similarly, the difficulties some bankrupt people experience in opening a bank account are caused by the attitudes of banks, rather than by bankruptcy law. These difficulties are symptomatic of the prevailing attitude to failure in Scotland, which contrasts with attitudes in the USA, where there is much less criticism of failure and more emphasis placed on being given the chance to try again.

3 Key Issues in the Study of Business-related Bankruptcy

3.1 Introduction

3.1.1 The purpose behind the scoping study was to prepare recommendations for a larger, more detailed study of business-related bankruptcy in 2001. The scoping study was therefore aimed at developing an understanding of the issues involved in business-related bankruptcy, and in defining possible research approaches.

3.1.2 The main issues identified in the scoping study, and which impact on the design of a main study, include:

- the difficulty of defining business-related bankruptcy and distinguishing between business-related and consumer bankruptcies;
- the potential importance of personal responsibility in business-related bankruptcies;
- the impact of bankruptcy on the businesses affected, and how this could have been changed;
- examining the relative effectiveness of sequestration against its objectives, and identifying potential alternatives.

3.2 Distinguishing between business-related and consumer bankruptcy

3.2.1 At present, bankruptcy statistics in Scotland do not distinguish between business-related and consumer bankruptcies at even the most basic level. This is clearly an important omission, since it severely limits the extent to which the impact of government policies regarding business start-up, growth and long-term development can be measured in terms of the long-term sustainability of businesses.

3.2.2 Thus while business growth is encouraged, maintaining the status quo is not given significant attention and management of decline or recovery is neglected by most business support agencies. This imbalance in the support offered to businesses appears to contribute to the incidence of business-related bankruptcies, but the lack of statistical data on the numbers of business-related sequestrations and protected trust deeds makes it impossible to examine inter-relationships such as these in any detail. The primary task for a main study would therefore be to derive an appropriate means of monitoring business-related bankruptcies in a meaningful, reliable and reproducible way.

3.2.3 The most appropriate definition for business-related bankruptcy in the Scottish context is not immediately obvious, although a number of options do exist.

3.2.4 At a simple level, it is possible to define business-related bankruptcy entirely on the basis of whether or not the debtor has any involvement in running a business. However, experience in other jurisdictions, and experience from the scoping study, suggest that such an approach is too simplistic to be useful.

- 3.2.5 Various examples of statistics of business-related bankruptcies can be found in other jurisdictions¹⁹. Different jurisdictions use different definitions, and in some the adopted definitions do not appear to be applied consistently. An important element in some of these definitions is whether all outstanding debts, or a certain proportion of them, are business debts, as compared with consumer debts. One option for identifying business-related bankruptcies in Scotland would be to follow this approach, and to use simple information provided by debtors about their debts, to categorise cases according to the nature of the debt.
- 3.2.6 However, there are problems with employing this approach. Some debts can quite easily be categorised as business-related (for instance, debts to commercial suppliers, Inland Revenue or Customs & Excise, or debts for professional fees), while others are obviously consumer debts (for instance, debts on store cards, for catalogue purchases or, less clearly, for council tax). In other cases, however, it may be difficult, or impossible, to tell at first glance whether a particular debt is business- or consumer-related, without obtaining additional information from either the debtor or the creditor. Debts owed to banks and utilities companies are examples – since they could relate to either consumer spending, or to business spending.
- 3.2.7 In addition, however, even if the nature of the debt itself could be accurately established, this would not provide evidence about how the debts had arisen. Even those debts which are clearly business debts – such as arrears owed to the Inland Revenue or Customs & Excise – may have in fact been incurred due to excessive drawings having been taken from the business in order to support consumer spending. Similarly, debts such as credit card debts, which may appear to constitute consumer spending, may in fact have been incurred through the credit card being used to provide working capital for the business; and personal loans may have been taken out to support the business.

Table 4. Approaches to defining business-related bankruptcy

Approach	Brief description	Comments
Association with trading as a business	Any evidence that the debtor has traded, or is trading, as a business at the time the debts were incurred	Limited in scope; will tend to overstate the number of business-related bankruptcies Easy to measure
Nature of debt	Examine the composition of the debts involved - take as business-related if more than a given proportion of debts are business debts	Better measure, but could be difficult to assess the composition of debts; would require some investigation of the debts

¹⁹ Notably in USA, Canada, Australia and England & Wales.

3.2.10 Details provided by a trustee about one particular bankruptcy illustrate the type of case belonging somewhere in the middle of this continuum:

"Around 4 or 5 years ago, if the debtor was insolvent then he was only marginally so - £2-3k. Over the past two or three years he has suffered bad debts of around £5000. The business was making £15k - £25k but turnover and profits have declined. Work referred by manufacturers has declined. His wife lost her baby and stopped working for 2 or 3 years which added pressure to household finances. Profitability has fallen from £10k to £15k but expenditure has continued unabated. Moved to a bigger house with a larger mortgage in 1998. This is acknowledged as a serious mistake as the timing could not have been worse!"

3.2.11 While it is clear that personal expenditure played a part in this particular bankruptcy, the debtor's main debts are owed to Customs and Excise and various trade suppliers. The relative failure of the business over recent years clearly contributed to the bankruptcy. However, this was combined with the "personal excess" of moving to a larger house with a bigger mortgage, despite household finances being under pressure due to the reduced profitability of the business and to the loss of a second income.

3.2.12 For the purposes of a main study into business-related bankruptcies it is proposed that sufficient information be gathered about each bankruptcy for both the **nature** of the debts, and their **root cause** to be identified. Having gathered this information it will be possible to identify the characteristics of the continuum, how to position individual examples of bankruptcy within the continuum, and how to identify meaningful groupings of bankruptcies. As a result of this process it will be possible to develop a simple and repeatable basis for distinguishing business-related and consumer-related bankruptcies, which could then be used for permanent statistical monitoring purposes.

3.3 Assessing debtor responsibility for bankruptcy

3.3.1 The research undertaken in the scoping study suggests that both professional people, and debtors themselves, would like to see a distinction being made between honest people who go through bankruptcy and those who are dishonest or guilty of fraud. Within the literature on bankruptcy, proposals also exist for bankruptcy law discriminating between bankrupts on the basis of their honesty or dishonesty.

3.3.2 At present, if a trustee suspects fraud, or that an offence has been committed under bankruptcy legislation, the case will be referred to the Crown Office and may eventually lead to prosecution. In practice, it would appear that relatively few cases are pursued, and that the number of successful prosecutions is low, though statistics are not currently available. Clearly, if bankruptcy legislation were to discriminate between the honest and the dishonest, the latter category would include those who had been successfully prosecuted. Attempting to include bankrupts in the "dishonest" category without such evidence would appear to be a project fraught with difficulties and dangers, and would certainly raise human rights issues.

3.3.3 Nevertheless, an assessment of the extent of the debtor's own responsibility, or even culpability, may be seen as making an important contribution to understanding business-related bankruptcy, and the different pathways to bankruptcy.

- At one extreme there may be cases of business failure which arise for reasons entirely outwith the businessperson's control – a downturn in the market, strong competition, suddenly increased costs – for which there may be little remedy, other than perhaps a clear change of business direction.
- Personal problems commonly play a role in bankruptcy, and in some cases business failure may have been precipitated by problems such as ill health, family breakdown, bereavement or alcoholism. Such problems may distract the person running a business, resulting in a fall-off in work undertaken, or inattention to some aspects of the business, perhaps resulting in loss of financial control.
- There are also cases of business failure which have more predictable causes and which early business advice might be able to prevent. Such causes include under-capitalisation of the business venture, unrealistic cash projections, ineffective management, over-trading, lack of financial control and over-staffing.
- At the far end of the spectrum are the instances of recklessness or dishonesty. Perhaps a business owner tries to trade him/herself out of trouble, knowing that the odds are stacked against success, or even deliberately engineers a business failure in order to avoid mounting debt and as a step towards re-starting under a new trading name.

3.3.4 Even in some of these last cases, however, the apparent recklessness may have been caused by panic, or a desperate desire to save the business, rather than deliberate dishonesty. Where the business owner employs staff, he/she may attempt to continue trading, against the odds of success, in order to protect the jobs and security of the staff, and may incur debts in order to do so. To the debtor, their actions may appear responsible and in the best interests of the business and the staff. To an outsider, such actions may appear irresponsible, ill-judged, or even bordering on the dishonest.

3.3.5 In the absence of a prosecution, it may be inappropriate to distinguish bankruptcies on the basis of the dishonesty of the debtor. However, as part of the investigation into individual bankruptcies for a main study, it is proposed that an assessment be made of the extent of the debtor's responsibility. This element could then be built into the understanding of business-related bankruptcy developed during the course of a main study, and used to help determine the placing of individual bankruptcies within the continuum.

3.3.6 In addition, it may be appropriate for this main study to undertake some specific investigation of bankruptcy cases in which dishonesty has either been alleged or proven, through submission of suspected offences reports and/or prosecutions. As well as providing statistics about the numbers of such cases, and their outcome, this investigation should help to clarify the characteristics of cases where culpability is clear, and the ways in which these differ from the majority of cases.

3.4 Outcome of bankruptcy for the business

- 3.4.1 The research undertaken during the scoping study suggests that there is a range of possible outcomes for businesses involved in bankruptcy. In some cases the business has already been closed down prior to sequestration taking place, while in others the business is closed down at the time of the sequestration. Yet there are also cases in which the trustee continues to run the business, for varying lengths of time, in order to sell it on as a going concern, and some sole traders simply continue trading throughout, apparently unaffected by the sequestration. As part of the investigation into individual bankruptcies for a main study, it is therefore proposed that an examination be undertaken of what happened to the business at the time of sequestration, the circumstances of each individual case, and the factors contributing to this outcome.
- 3.4.2 The findings of the scoping study also suggest that if business people were to seek assistance, and were able to obtain the specialist advice and support needed, then in a proportion of cases sequestration might be averted. As an additional element in the investigation into individual bankruptcies for a main study, it would therefore be useful to undertake an objective assessment of the underlying viability of the business, and whether appropriate intervention could have turned the business around. Included in this assessment would be questions of whether the business was only apparently insolvent, or whether it was also practically insolvent and/or absolutely insolvent, and whether the business was essentially profitable though experiencing cash flow problems, or clearly unprofitable.

3.5 Relative effectiveness of sequestration

- 3.5.1 It is clear from the research in the scoping study that the process of sequestration is of limited benefit. For the creditor it offers a very low return in comparison to other means of debt recovery and for the debtor, in cases resulting from creditor petitions, the process can seem, and often is, draconian in its impact and difficult to escape from. The only area where it is perceived as offering significant benefit is in cases where the debtor petitions for his/her own sequestration - in which cases it can offer welcome relief to the debtors from the burden of debt they carry. Even in these cases, however, debtors often appear unaware of the true impact of the process, and only learn of these after the event, by which time it is difficult or impossible to reverse the process.
- 3.5.2 A full study should therefore address the extent to which the current options offered by legislation meet their objectives: what they offer the creditor, the debtor, and those involved in the administration of the process.
- 3.5.3 As part of this, an assessment of whether the sequestration is likely to result in a dividend being paid out to the creditors should be included in the investigation undertaken into individual bankruptcies. This would help identify how those business-related bankruptcies resulting in payment of a dividend differ from the rest. From the point of view of the creditors these would appear to be the most “successful” bankruptcies, but it will be important to establish in what circumstances, and at what cost to others (such as employees, the business community), this success is achieved.

4 Main Study – Objectives

4.1 Introduction

4.1.1 The driving force behind such research into business-related bankruptcy would be to identify ways of helping the business start-up and survival rates in Scotland, and to encourage entrepreneurial activity in the business community:

- by reducing the likelihood of business failure and bankruptcy occurring;
- by encouraging (genuine) business people who have gone bankrupt to recover quickly, and to use their experience of failure to help build successful businesses;
- by reducing the negative impact that the fear of bankruptcy may have on entrepreneurial activity.

4.1.2 The aim of the study would be to advise Ministers on:

- ways of reducing business failure (and equivalently, encouraging the development and survival of strong businesses);
- recommendations for establishing routine statistical monitoring systems for business-related bankruptcy and its effects;
- recommendations for change to the bankruptcy legislation, including potentially the need for different treatment to apply to business and consumer bankrupts, or according to the degree of responsibility for the bankruptcy attributable to the debtor.

4.2 Addressing the objectives

4.2.1 In order to address these objectives and aims, a main study would need to focus on a range of issues. These would include:

- the development of an understanding of the incidence and characteristics of all bankruptcies, and of how to distinguish between business-related and consumer bankruptcies;
- the identification of how support could be provided more effectively at an early stage to businesses in difficulty, in order to reduce the incidence of business failure and the need for sequestration;
- the analysis of business-related bankruptcies according to the causes leading to them;
- the establishment of baseline figures on the incidence of business-related bankruptcy, to enable monitoring of trends in the future;

- the development of a better understanding of the pathways to bankruptcy in the business situation;
- examination of the effectiveness of sequestration against its key objectives;
- identification of whether there are alternatives to bankruptcy which could achieve the same overall objectives more effectively, perhaps for specific case types;
- assessment of the impact of bankruptcy on the individuals involved - the bankrupts themselves, their families, their creditors, professional practitioners, and the wider business community;
- the identification of ways in which bankruptcy law and practice could be altered, in order to result in better business sustainability, higher business start-up rates, and a reduced negative impact on genuine business people;
- learning from the best practices in other jurisdictions, and the identification of the extent to which they could work in Scotland.

4.3 Information to be gathered

4.3.1 In order to focus on these issues, the research in a main study would have to gather a range of information about:

- sources of business support and advice;
- the incidence and characteristics of business-related bankruptcies;
- the effectiveness of sequestration and of alternatives to sequestration;
- the impact and effects of business-related bankruptcy;
- how current bankruptcy legislation works in practice, and potential changes to existing bankruptcy law.

Sources of business support

4.3.2 The information required would include:

- sources of information, advice and support available to businesses in difficulty, and gaps in this provision;
- methods for detecting businesses in difficulty at an early stage, in order to provide the support needed;
- methods for encouraging businesses in difficulty to seek the support available;

- the most effective ways of providing advice and support to businesses in difficulty, and the extent to which it can prevent the need for sequestration in practice.

Number and characteristics of business-related bankruptcies

4.3.3 The information required would include:

- the numbers and characteristics of all bankruptcies, from which to examine the characteristics of those which are business-related;
- the causes and types of business-related bankruptcy, including the nature of the debts, the root cause of the debts and the degree of responsibility of the debtor;
- the numbers and characteristics of bankruptcies which involve apparent dishonesty;
- the outcomes for businesses involved in bankruptcy, and possible alternative outcomes, including an objective assessment of the viability of the business had sequestration not occurred;
- the distribution of business-related bankruptcies according to the various identifiable causes and types;
- the different pathways to bankruptcy, through looking at issues such as: how do people end up bankrupt? What factors influence the outcome? What factors influence the decision-making process along the way?

Effectiveness of sequestration

4.3.4 The information required would include:

- the effectiveness of sequestration in achieving its objectives, and those of the organisations/individuals who petition for sequestration, including as a means of debt recovery, and as a means of control over debt in business;
- how sequestration relates to alternatives (diligence, protected trust deeds) in terms of effects, costs, amount recovered by creditors and long term impact;
- how sequestration and other alternatives are viewed by businesses in general, and by those who have experienced sequestration;
- how the different players view the options at each stage leading to sequestration, and hence what other alternatives could be offered.

The impact and effects of business-related bankruptcy

4.3.5 The information required would include:

- how the possibility of bankruptcy affects those starting up in business or contemplating the prospect;
- how bankruptcy affects individuals: the immediate, short and long term effects; the impact of bankruptcy on the future business activity of those who experience it;
- the secondary effects of bankruptcy, which may be more to do with attitudes and practice, rather than with the law itself (for example, the reluctance of suppliers to offer credit to bankrupts);
- the different perceptions of the bankruptcy process of those involved, including debtors, creditors, insolvency practitioners, and the relations between these different perceptions.

Current bankruptcy legislation and potential changes

4.3.6 The information required would include:

- what can be done to reduce the negative impact of business-related bankruptcy on business start-up and legitimate entrepreneurial activity (if one exists);
- what can be done to reduce the negative impact of experiencing significant debt problems, and failing in business;
- what can be done, in relation to bankruptcy legislation, and in other respects, to improve business survival rates in Scotland;
- what can be learned from other jurisdictions.

5 Main Study - Methodologies

5.1 Introduction

5.1.1 In order to gather the information required by a main study, and to address its objectives (as described in Section 4), it is envisaged that the study would comprise seven main strands:

- a literature review, based on, but not limited to, the list of relevant references provided in the scoping study's Second Strand Working Paper (LR);
- a statistical data collection exercise to collect objective data on the incidence and causes of business-related bankruptcy, and alternatives to it (SD);
- questionnaire-based surveys, involving entrepreneurs and key groups of individuals affected by, and working with, bankruptcy, trust deeds or diligence, to collect both qualitative and quantitative information on the causes, processes and implications of sequestration and associated measures (QS);
- interview-based research with a selection of questionnaire respondents, to provide more in-depth information (IR);
- case study-based research, following through a number of selected bankruptcies, involving interviews with all the key players involved – to provide a greater understanding of the processes involved in bankruptcy, of the differences of perception between different key players, and the interactions between them (CS);
- review of sources of advice and support to businesses, and their applicability to businesses experiencing difficulty; assessment of their current services in relation to business needs and identification of potential development areas to serve business need better (AS);
- an action research study, to examine potential alternatives or diversions from the sequestration process (AR).

5.1.2 Table 5 (overleaf) illustrates how each of the suggested methodologies would contribute towards providing the information required by a main study.

Table 5. Contribution of different methodologies towards required information

Information required		Methodology (see codes above)
Business support and advice	Sources of information, advice and support	AS, QS, IR
	Methods for detecting businesses in difficulty	LR, AR
	Methods for encouraging businesses to seek support	LR, AR
	Effective ways for providing support to businesses in difficulty	LR, AR
Incidence and characteristics of business-related bankruptcies	Numbers of business-related bankruptcies	SD
	Causes and types of business-related bankruptcy	SD
	Outcomes for businesses involved in bankruptcy	SD
	Pathways to bankruptcy	SD, QS, IR, CS
Effectiveness of sequestration and of its alternatives to sequestration	Effectiveness of sequestration in achieving its objectives	LR, SD, QS, IR, CS
	Relative effects of sequestration and alternatives	QS, IR
	Views on sequestration and alternatives	QS, IR
	Other potential options	QS, IR, AR
Impact and effects of bankruptcy	Impact on individuals: the debtor, the debtor's family, creditors, professionals	QS, IR,
	Impact on business start-up, growth, entrepreneurial activity	QS, IR,
	Secondary effects of bankruptcy	QS, IR
	Different perceptions of the different parties involved	QS, IR, CS
Experience of current legislation, potential for change	Options for reducing the negative impact of bankruptcy on business start-up and entrepreneurial activity	LR, QS, IR
	Options for reducing the negative impact of experiencing business failure	AR
	Options for increasing business survival rates	AR

5.2 Literature review

5.2.1 The scoping study has included a survey of the literature available on insolvency both in Scotland and elsewhere, and provides a starting point for a detailed literature review in a main study²⁰.

²⁰ A list of references is provided in Annex C.

5.2.2 The literature identified to date provides useful information on a number of key areas:

- the aims and objectives of bankruptcy law - the role and function of bankruptcy in society; bankruptcy in relation to other means of recovering debts;
- legislation - reviews of the current and past legislation on bankruptcy and debt recovery, both in Scotland and elsewhere; problems identified with existing legislation, and proposed reforms;
- data on the incidence of bankruptcy - analysis of data sources both in Scotland and elsewhere, comparisons, identification of gaps and discrepancies;
- case studies – of how businesses fail, of consumer and business bankruptcies; factors affecting progress towards bankruptcy;
- issues affecting business growth, failure, rescue and long-term survival; entrepreneurial activity; corporate insolvency legislation;
- money and debt management advice - sources of advice and support to businesses; details of their effectiveness.

5.2.3 The purpose of the literature review would be to contribute towards identifying the strengths and weaknesses of the current Scottish bankruptcy legislation. It would involve comparing the experience in Scotland with that of other jurisdictions, with different bankruptcy legislation, and different approaches to the management of business debt and business failure, identifying the strengths and weaknesses of each, and their applicability in Scotland. This may suggest alternative means of meeting the needs of creditors, reducing the incidence of business failure, and reducing the negative impact of bankruptcy on the individuals concerned.

5.3 Statistical data collection

5.3.1 There are two reasons behind the need for a statistical data collection exercise in a main study.

- Firstly, on a short-term basis, it would be necessary to gather together as much information as possible on the incidence and characteristics of bankruptcies - both consumer- and business-related. For practicality's sake, and to enable sufficient numbers to be collected in the timespan for the study, this data collection exercise would be partly retrospective - looking at records of past sequestrations to identify their characteristics and to examine how bankruptcies can best be classified in order to distinguish between business and consumer. In addition to the retrospective analysis, some research with current bankrupts would also be undertaken.
- Secondly, on a continuing basis, to design a statistical monitoring system to enable routine information on the incidence and nature of business-related bankruptcies to be collected.

Short term, detailed study

- 5.3.2 Two main approaches exist for the collection of retrospective data on business-related bankruptcies, these being analysis of the computerised Register of Insolvencies, and analysis of information in the individual bankruptcy files held at the Office of the Accountant in Bankruptcy. Using these two approaches it would be possible to make an accurate assessment of the number of bankruptcies which have involved businesses, during recent years, and of the nature of the debts involved in the bankruptcy, in terms of their balance between business and consumer debts. It would also be possible to compare the business-related bankruptcies with purely consumer bankruptcies in terms of the proportion of debtor and creditor petitions, the gender of the debtor, value of assets and liabilities, the return to creditors, and other significant factors. Analysis of this data would help to design the basis of the ongoing statistical recording system proposed for a main study, and to allow its continuation beyond completion.
- 5.3.3 For current bankruptcies, the approach would be based on research with recently bankrupt people themselves, including specific accountancy investigation of their business books, in cases where a business is involved. This investigation could focus on issues such as: the profitability of the business; market placement; the level of working capital, drawings, and bad debts; the quality of management and financial control; personal problems, and evidence for dishonesty/fraud. This additional research would enable identification of the root cause(s) of the bankruptcy, the extent of the debtor's responsibility, the outcome of bankruptcy for the business, and the viability of the business at the time of sequestration.
- 5.3.4 A number of additional options also exist for the collection of data from insolvency practitioners about the individual cases they are dealing with. One option would be to collect data about the realisation of debtors' assets, and particularly their home, in order to build up statistics about the number of evictions, voluntary sales, etc. A second option, would be to collect data about bankruptcies where offences have been suspected and/or prosecuted, and a third to collect data about the protected trust deeds entered into by trustees, their circumstances, and characteristics.

Continuing statistical data collection

- 5.3.5 The long-term approach to the creation of an easily administered statistical data collection system would be likely (at least at this stage) to be based on the inclusion of a number of additional questions in the Supplementary Questionnaire currently completed by trustees/agents about each individual bankruptcy. This additional information might be held in the computer-based register of bankruptcies, for later extraction of the statistical data, or input to a separate statistical system.
- 5.3.6 The purpose of the data collection would be to provide objective baseline data on the incidence of business-related bankruptcy and its various causes and outcomes. This data will be crucial to developing an understanding of the scale, and nature, of the problem being caused to Scottish enterprise by existing bankruptcy law. Analysis of the data would provide the background against which any possible changes to bankruptcy law should be developed, and their implications assessed. In addition, analysis of the data would enable development of a set of questions for permanent

inclusion in the Supplementary Questionnaire, to enable on-going statistical monitoring of business-related bankruptcies.

5.4 Questionnaire surveys

5.4.1 During the scoping study, a range of issues has been identified about which more information would be required by a main study, including data for quantitative analysis. A number of questionnaire-based surveys would therefore be required in a main study, to gather information about the experiences and views of a statistically valid sample of relevant individuals. Groups to be covered by questionnaire surveys would include debtors, creditors, insolvency practitioners, solicitors, business people, and advisors – both business advisors and money advisors. The business people to be surveyed would include the full range, from those running new business start-ups, and successful mature businesses, to those experiencing varying degrees of debt problems, including diligence, and sequestration itself.

5.4.2 The sampling approach taken for each group covered by questionnaire surveys would be to draw a random sample from available registers, stratified by geographical location, and in some cases by additional factors (such as size of business, business sector, legal status of business, etc.). Although the detailed questionnaire design and content would be specifically tailored for each of the groups surveyed, as much as possible will be made common to all, to aid comparison of the results. The areas to be covered by the questionnaires would include:

- sources of information, advice and support to businesses in difficulty, and gaps in these;
- the causes of business-related debt and bankruptcy;
- business-related debt, consumer debt, and the relationship between the two;
- options for dealing with debt, how decisions are made about these;
- pathways that lead to bankruptcy;
- what can be done to tackle the causes of debt in order to avoid bankruptcy;
- the objectives underlying bankruptcy law, and the process of bankruptcy;
- the alternatives to sequestration;
- the relative efficacy of sequestration and of alternatives to it, in terms of benefits achieved for creditors, relief for the debtor, benefits to society as a whole, cost to the public purse, and preservation of enterprise;
- the impact of business failure and sequestration on the debtor;
- the impact of sequestration on start-up, growth and entrepreneurial activity;

- the secondary effects of bankruptcy;
- the objectives of the practitioners, advisors, officials, policy makers etc;
- the extent to which these objectives are currently fulfilled, and what the constraints on their fulfilment are.

5.4.3 The completed questionnaires would provide quantitative data on the experiences and views of people who have had involvement with bankruptcy, either personally or professionally. In addition, the completed questionnaires would help to identify cases for further, more detailed study, including through face-to-face interviews and using a full case study approach.

5.4.4 The data from the questionnaires would be compiled into an appropriate form of database, in anonymised form, to assist other, later, research.

5.5 Interview surveys

5.5.1 In-depth face-to-face interviews (or telephone interviews in some instances) would be necessary for following up the more subjective elements of the experiences of bankruptcy, the options open to creditors and debtors, and the possibilities for action to help businesses out of trouble. The people and/or organisations selected for interview would be drawn from those responding to the questionnaires, with the addition of other groups such as policy makers, business-related organisations, money advice organisations, organisations supporting ethnic minority groups in business, academics, credit agencies and credit rating organisations.

5.5.2 Interview design and content would be required to be different in each case, though consistent lines of questioning would be used whenever possible, to aid comparison of the results. The subjects to be examined during interviews would be the same as those covered by the questionnaires, but this methodology would enable a much more detailed in-depth coverage of the issues.

5.5.3 The results of each interview (with personal identification details removed) would be compiled into a suitable form of database for later analysis and in order to contribute to other research studies.

5.6 Case studies

5.6.1 When a bankruptcy occurs a number of different players are involved, of whom the debtor, the creditors and the trustee/agent are perhaps the most significant. The scoping study has found that the perceptions these key players have of the events leading up to, and following, sequestration are often markedly divergent. Debtors frequently feel that their creditors have treated them badly, while creditors have the same view of their debtors. Debtors may also feel that they have been treated unreasonably by their trustee, while trustees acknowledge that debtors feel this way, but suggest that this is due to the debtor's failure to accept responsibility for the situation they find themselves in. As part of a main study into business-related bankruptcy, it is proposed that adopting a case study approach could enable

exploration of these different perspectives, with a view to better understanding them, how they arise, and how they can be reconciled.

- 5.6.2 The case study-based research would involve the selection of a small number of bankruptcies for in-depth study, including interviews with a range of key players who have been involved in the same bankruptcy case. Cases would be selected from completed questionnaires following initial interviews with debtors; the case studies would include interviews with key creditors, the trustee(s), and supervisory staff at the Office of the Accountant in Bankruptcy. Potentially, case studies could also include interviews with money advice workers, business counsellors, the debtor's accountant, creditors' solicitors, sheriff officers, court staff and the relevant member of the judiciary. Interviews would focus on the detail of the particular case, in order to build up a complete picture of the case, and the divergent views of those involved in it.
- 5.6.3 Adoption of the case study approach would enable investigation of the decisions made by both debtors and creditors, in the lead up to bankruptcy, and the consequences of these - both intended and unintended. In addition, it would enable investigation of how trustees administer cases, and the consequences of their actions - both intended, and unintended - for debtors. The purpose of the case study approach would thus be to develop a more detailed understanding of the processes involved in bankruptcy, including both the lead up to bankruptcy and the process of sequestration itself.
- 5.6.4 Each case study would be written up in full (with all personal identification details removed) and would be available to future research studies, to provide material for training Insolvency Practitioners, debt advice professionals and others involved in the administration of bankruptcy or in business advice and guidance.

5.7 Review of sources of advice and support

- 5.7.1 The scoping study suggests that the key to reducing business-related bankruptcies in the future will be the availability and provision at an early stage of appropriate advice and support to businesses in difficulty. It also suggests that suitable sources of advice are not always readily available to businesses, though there is an increasing awareness of the need for it. The current focus of business advice and support agencies is primarily on business start-up and growth, less on routinely trading businesses, and even less on businesses in difficulty.
- 5.7.2 As part of the research in a main study, we are proposing a systematic identification and review of the services available to businesses in difficulty, and how relevant these are to the needs of businesses as currently identified.

5.8 Action research

- 5.8.1 Research undertaken during the scoping study has suggested that, in many cases, it may be possible for bankruptcy to be averted, if the debtor receives appropriate business advice and support at the right time. One aim of the data collection element of a main study would be clearly to establish the proportion of bankruptcies in which this is the case. It is proposed that a main study should also include an action research

project, actually to trial the provision of appropriate business support, and to assess its efficacy in promoting business survival and averting bankruptcy.

5.8.2 The action research approach was first developed after the 2nd World War, and has since been used extensively within complex social situations, though especially within education. The design of an action research project is typically iterative, with the different parts of the process being cyclically repeated, these being:

- exploration - of the problem and development of understanding;
- planning - the action to be taken;
- implementation - of the planned action or intervention;
- observation – including monitoring the intervention and its effects;
- reflection – consideration of the effects of the intervention.

5.8.3 Within a main study it is proposed that one or more schemes for providing highly focused support to businesses experiencing difficulty should be tried. The effects of such schemes would then be monitored, and evaluation undertaken of how they are contributing towards both increasing business survival rates, and averting bankruptcy. Evaluation would include consideration of the practicality of rolling out the schemes on a national basis, the costs of doing so, and the benefits to be gained. The purpose of including action research within a main study would therefore be to establish clearly the benefits of providing appropriate support to businesses in difficulty.

5.8.4 An initial exploration of the issue has already taken place during the scoping study, and a number of suggestions for possible action research projects have emerged, including:

- **well business clinic** - a source of information and advice to be offered to businesses trading normally, or those in some trouble at an early stage - often before the business itself knows it is in trouble. Such a clinic could offer a free check-up and diagnostic information on businesses, and sound professional advice for those in, or heading for, trouble;
- **key performance indicators** - publication of a set of key performance indicators that might help to highlight to businesses that they may be heading for trouble;
- **debtline** - an anonymous telephone helpline to provide information and advice to businesses in difficulty, to offer professional advice, and encourage management action to be taken on debt before the burden becomes insuperable;
- **intensive care unit** – aimed at rescuing businesses that are in severe difficulty and where the owner, partner or director is heading for sequestration. This service could offer an independent assessment of the viability of a business, and

– if considered worth rescuing – provision of the support and resources required to attempt rescue;

- **recovery and rehabilitation** – aimed at assisting bankrupt people return to business, this service would include finding practical ways of tackling the barriers bankrupt people encounter, as well as providing the advice and support they need.

5.8.5 The first stage of an action research project to take place during a main study would be detailed planning of the action to be taken, and of its evaluation.

6 Main Study - Feasibility

6.1 Introduction

- 6.1.1 A range of methodologies has been proposed for use in a main study into business-related bankruptcies, which together would provide a comprehensive research package, able fully to meet the objectives of the study. However, many of these methodologies do present practical difficulties, which may reduce their utility, or indeed the feasibility of using them, or make the cost of doing so prohibitive.

6.2 Collection of retrospective data

- 6.2.1 The Register of Insolvencies is computerised, and analysis of the data held in it is therefore expected to be a relatively straightforward task. However, the data held on this Register is incomplete: not all bankruptcies involving a business are identified as such on the Register (in a sample tested during the scoping study the Register omitted to refer to the business involvement in around 20% of cases). Nor does the Register include the detail required to establish the root cause of the bankruptcy, or even the nature of the debts. Analysis of the Register can therefore only provide an inaccurate, and partial, picture of business-related bankruptcy in Scotland. If the limitations of this data are accepted, however, its analysis can be seen to provide some useful background information about business-related bankruptcies in Scotland. It would give a rough estimate of the proportions of bankruptcies involving a business, and allow analysis of how these compare with purely consumer bankruptcies on a number of criteria. Given the relatively straightforward analysis task, and the current complete lack of baseline data, this should be well worth undertaking.
- 6.2.2 Inclusion of information contained in the bankruptcy files held at the Office of the Accountant in Bankruptcy would be a significantly more time-consuming task. With around 3,000 new files each year, it is estimated that a researcher would have to work full-time for at least one month in order to extract the details required to establish firmly if there was business involvement in each of one year's bankruptcies. Since not all files include a Supplementary Questionnaire (18% of files lacked one in 1999), and since the Supplementary Questionnaire is the main source of the data required for the study, additional work would be required in these cases, perhaps involving telephoning the trustee/agent working on the case to request the required details.
- 6.2.3 Analysis of the information extracted in this way would enable a much more accurate assessment of the number of bankruptcies involving a business than could be obtained from the Register of Insolvencies alone. However, extracting additional information, such as the causes given for insolvency in the Supplementary Questionnaire and the nature of the debts (the breakdown between business and consumer debts), would increase the time required to extract data from each file. In both of these cases the data available would undoubtedly be found to be inconclusive in many, if not the majority, of cases. Furthermore, the bankruptcy files do not include any details to enable analysis of the root cause of the bankruptcy, and nor do they include any details about whether the trustee continued trading a business to sell it as a going concern, or what happened to the debtor's house.

- 6.2.4 Overall, therefore, the utility of spending extended periods of research time extracting data from the bankruptcy files, should be carefully weighed up. In addition, prior to undertaking this research, it would be necessary to establish whether this would be acceptable under data protection legislation. No problem is anticipated, since use of data for research purposes is generally included in the registration under the Data Protection Act, however, this would have to be positively established before the research could be undertaken.
- 6.2.5 The most appropriate method of recording any additional data obtained from the bankruptcy files would be to take a copy of the Register of Insolvencies, and add the new information to this copy. This would minimise the use of staff time at the Office of the Accountant in Bankruptcy, while maximising the use to which the additional data could be put, in terms of analysis and output.
- 6.2.6 Collection of retrospective data from other sources would involve a range of additional problems and issues. One option would be to request access to the bankruptcy files of individual insolvency practitioners – but even if the insolvency practitioners were willing to provide such access, it is doubtful that data protection legislation would allow it.

6.3 Collection of current data

- 6.3.1 Inclusion of some additional questions in the existing Supplementary Questionnaire should be a relatively straightforward task, which should not add significantly to the complexity or time taken to complete it. Firstly, these questions could clearly establish whether a business had been involved in each individual bankruptcy. Further questions could then be used to gain the insolvency practitioner's view of: the nature of the debt, the root cause of the debt, the extent of the debtor's own responsibility for the bankruptcy, the outcome for the business and the viability of the business had sequestration not occurred. A draft set of questions has already been produced as part of the scoping study, and a number of insolvency practitioners have been asked to trial their use and comment on the feasibility of their inclusion in the questionnaire. The practicality of the questionnaire's approach has therefore been tested.
- 6.3.2 Once the additional questions had been finalised in the planning for a main study, it would be important to ensure that all insolvency practitioners are aware of the updated Questionnaire, and that they make use of it, rather than of an older version. It is currently a practical difficulty that practitioners do not always use the latest version of the Questionnaire, and as noted above, questionnaires are not included in a significant number of cases. Guidance notes would need to be produced, to provide assistance in answering the additional questions and to encourage the use of the correct version of the questionnaire. During a main study, the information collected in this way would be extracted from the Supplementary Questionnaires by the research team, recorded and analysed by them. Since no Supplementary Questionnaire is currently completed in approximately 20% of bankruptcies, the data provided from this source would not be comprehensive, and it would be necessary to follow-up the missing cases by personal contact with trustees.

- 6.3.3 To undertake additional research with recently bankrupt people, including investigation of their business books, would be a significantly more time-consuming and difficult task, and would require the resolution of a number of issues.
- 6.3.4 Firstly, it would be critical to develop clear criteria to be applied in collecting the data, and undertaking the investigation, in order to ensure that the data gathered is both consistent and objective. These criteria would have to be developed by working closely with a small group of insolvency practitioners and accountants, considering such issues as how to define “excessive drawings”, and how to identify “poor financial control”. Having established the criteria to be employed, initially, a number of different strategies would need to be tried for the undertaking of the task itself. One such strategy would be to ask for volunteers, from amongst existing trustees and agents, to take on the additional work for an additional fee; another would be to employ suitably qualified researchers specifically for the task, having first taken a view of what qualifications would be required. An early assessment of the advantages and disadvantages of these different strategies should then be made, together with an assessment of the value of the additional information being obtained. The issues surrounding these approaches have been explored to some extent in the scoping study workshop, and at this stage the two approaches appear practicable.
- 6.3.5 A further difficulty with undertaking this investigation is likely to be that, in many cases, either no business books exist or the debtor may be unwilling for researchers to review them. In these cases, the investigation would have to rely entirely on face-to-face interview with the debtor, or in the absence of the debtor’s co-operation, on information obtained from the trustee. In such cases it is unlikely that sufficiently complete and objective data will be obtainable. Another significant issue about use of this methodology is likely to be the cost involved. In order for this approach to become a feasible option, it is likely that the detailed investigation proposed could only be undertaken into a sample of bankruptcies. It is suggested that perhaps 10% of those bankruptcies in which there is business involvement should be investigated (around 100 to 150 bankruptcies in total), stratified by type of business, amount of debt, gender and ethnic origin of the debtor.
- 6.3.6 The feasibility of collecting additional data from insolvency practitioners, particularly about trust deeds, must also be questioned. Unless legislation requires trustees to provide information to the Accountant in Bankruptcy, it would appear extremely unlikely that a significant proportion of them will be willing to provide the information on a regular basis. Strategies for obtaining this information must be considered in more detail, but one approach would be to recruit the services of a sample of current insolvency practitioners, and to seek their assistance in contributing to the study for its duration, on a paid basis.

6.4 Questionnaire surveys

- 6.4.1 As part of a main study, it is proposed that questionnaire surveys should be undertaken with all those groups involved in bankruptcy in a personal, or a professional capacity. For many of these groups of key players, the use of questionnaire surveys would be unlikely to pose any significant methodological problems – accurate registers exist, statistically valid sampling should pose no problems, and carefully designed questionnaires should result in a high return rate.

6.4.2 However, significant problems are anticipated where some of the groups of key players are concerned. Firstly, research undertaken during the scoping study suggests that the use of a questionnaire survey of debtors may encounter a number of problems in obtaining an acceptable response rate:

- the response rate to letters sent out to debtors during the scoping study was very low (6%);
- although the Register of Insolvencies includes debtor's addresses, no telephone numbers are included, and addresses are not updated if the debtor moves house. Research with directory enquiries only resulted in 20% of debtors' telephone numbers being found;
- many debtors are unwilling to take part in research into their bankruptcy, feeling this is an area of their life which they would rather not discuss.

6.4.3 Strategies do exist for obtaining up-to-date contact details for debtors, including asking trustees for this information, and use of the electoral register. However, all such strategies are bound to be time-consuming, and are likely to have only limited success. In addition, strategies do exist for maximising the response rate from debtors once their contact details are obtained. These include making contact by letter, and possibly telephone, prior to sending out the questionnaire, and making follow-up telephone calls. Again, however, these strategies are likely to be time-consuming, and to enjoy only limited success.

6.4.4 Selecting an appropriate sample for questionnaire surveys of some other groups, notably of businesses – be they creditors, start-up businesses, successful mature businesses, or experiencing debt problems – does pose methodological problems. Available registers significantly under-estimate small businesses that are not registered for VAT or PAYE, while in addition, it may be difficult to ensure that businesses at the required stage, or with the required experience of debt, are accurately represented in the sample drawn. Businesses with experience of formal debt-recovery procedures may be drawn from court records, though this would require some additional work since court records frequently do not indicate whether the debtor is an individual or a business.²¹

6.4.5 Undertaking a questionnaire survey of insolvency practitioners may also encounter some difficulties. If asked detailed information about the bankruptcies for which they have acted as trustee or agent, insolvency practitioners may be unable to provide answers without doing significant investigative work in their files, and may be unwilling to undertake such work.

6.5 Case studies

6.5.1 Use of the case study approach proposed for a main study relies on the full, and willing, co-operation of the debtor, and of other key players. There could be no

²¹ “because of the limited information contained in court records it was often only revealed during the course of the interviews that the debtor had incurred their debt through business activities” - Evaluation of the Debtors (Scotland) Act 1987: Study of Debtors, David Whyte, Scottish Office, 1999 p:11

question of undertaking this approach without the full approval of the selected debtors, and for this reason the approach is potentially problematic. It may prove difficult to find debtors willing to take part, and even then, it may prove difficult to get the co-operation of the creditors, trustee and other professional staff who have dealt with that particular bankruptcy.

6.6 Action research

- 6.6.1 As part of a main study it is proposed that one or more service for providing advice and support to businesses in difficulty be piloted, as an action research project. A whole range of feasibility issues must be addressed in assessing which of the suggested services would be most appropriate for piloting. One option would be for plans for the action research project to be developed following the emergence of the initial findings from a main study, particularly as regards the numbers of business-related bankruptcies, and causes of these bankruptcies.
- 6.6.2 In order to have a reasonable chance of success, any action research project would need to be very professionally organised, staffed and publicised. A major issue would be to ensure that businesses getting into difficulties are aware of the new service, and encouraged to use it. However, it would be even more important that the advice and support being given to those making use of the service was accurate, helpful, and appropriate to the needs of the businesses.
- 6.6.3 The costs of piloting any of the suggested action research projects would be considerable, but not out of proportion to the value of the research results. Effectively the action research would provide validated blueprints for practical services that could be offered to businesses and would reduce the incidence of business-related bankruptcy.

7 Recommendations for a Main Study

7.1 Introduction

- 7.1.1 The scoping study into business-related bankruptcy has clearly established that a need exists for further research. This study has gone a considerable way towards identifying the important issues affecting business-related bankruptcies, but in doing so has raised many more questions than have been answered. Specifically, the study has shown that the Scottish Executive were correct in identifying business-related bankruptcy as being an area of concern, and in identifying the need for the collection of accurate, objective data about the incidence of business-related bankruptcy and its causes. However, the findings of the scoping study would suggest that rather than bankruptcy law itself being the major point at issue, it must be seen as only one element in a complex web of cultural attitudes, public policy and legislation, which together have a negative impact on individuals and on enterprise.
- 7.1.2 The scoping study has failed to find any clear evidence that bankruptcy law itself is responsible for deterring potential entrepreneurs from starting up in business, though it may be acting to dissuade or prevent people from going back into business following sequestration. However, it does seem clear that a real issue exists around the provision of support to business people who are running into difficulties. Consequently, many business people do not receive the information and advice that might have enabled them to turn their business around, overcome their debt problems, and avoid sequestration.
- 7.1.3 While the experience of sequestration may serve to deter people from setting up another business, there is little doubt that the experience of failing in business, and building up intractable debt problems is also a very significant deterrent to further enterprise in many cases. The impact of providing effective business support would therefore go beyond avoiding bankruptcy itself, and would include reducing or preventing the negative impact of business failure itself.
- 7.1.4 A further thread in this negative web is that of the impact of cultural attitudes, and related legislation. These place restrictions on the opportunities available to bankrupt people, make it difficult for them to obtain credit, assume they are unfit to take public office or positions of responsibility, and reinforce the impression that bankrupt people are dishonest. A considerable stigma attaches to bankruptcy which, combined with a critical attitude towards failure and a risk-averse culture, assures the negative impact of bankruptcy far more surely than bankruptcy legislation itself.

7.2 Options

- 7.2.1 Against this background, a study of business-related bankruptcy is clearly needed, firstly to provide the baseline statistics required, secondly to provide a better understanding of its causes, and thirdly to establish how the negative impact of business-related bankruptcy could best be ameliorated, or bankruptcy itself avoided. The scoping study has identified a range methodologies for use in a main study, but it is clear that a number of practical difficulties reduce the feasibility of using some of these, and that the costs of others will be high.

7.2.2 Table 6 provides a summary of the feasibility issues. Also included are comments on the usefulness of each methodology, and an estimation of their importance to the study.

Table 6. Summary of feasibility issues

Component	Feasibility issues	Comments
Literature review	No significant issues	Useful – for background and comparative information
Analysis of Register of Insolvencies	Incomplete data, limited detail	Essential – for baseline data
Analysis of bankruptcy files at office of the AiB	Very time-consuming, data likely to be inconclusive in some cases	Desirable – but the research time and costs may outweigh the benefit
Additions to supplementary questionnaire	<p>Possible resistance from trustees towards completing all the relevant questions</p> <p>Possible difficulty in trustees being able to answer all the relevant questions</p> <p>No supplementary questionnaire completed in some cases</p>	Essential - for obtaining accurate statistical data on the number of business-related bankruptcies
In-depth investigation of individual bankruptcies	<p>Possible difficulty in:</p> <ul style="list-style-type: none"> - finding researchers with the right combination of skills to do the research - finding debtors willing to take part - defining criteria for classifying cases - obtaining sufficient in-depth, objective information, e.g. in the absence of business books 	<p>Essential - for obtaining the data required to identify causes of business bankruptcy, the outcome of the bankruptcy for the business, and the viability of the business at the time of sequestration</p> <p>Essential – for the development of an objective statistical monitoring system for future use</p>

Table 6. Summary of feasibility issues, continued

Component	Feasibility issues	Comments
Questionnaire survey of debtors	Possible difficulty in: - making contact with selected sample - obtaining an adequate response rate	Useful - for obtaining statistical data on the experiences and views of debtors
Questionnaire survey of creditors/ businesses	Will require an appropriately stratified sample	Useful - for obtaining statistical data on the experiences and views of creditors and businesses in general
Questionnaire survey of insolvency practitioners	Possible inability or unwillingness to provide detailed information	Useful - for obtaining statistical data on the experiences and views of insolvency practitioners
Interviews	Possible difficulty in finding debtors willing to participate	Useful - for obtaining in-depth data on key players' experiences and views
Case studies	Possible difficulty in finding debtors willing to participate, and in obtaining the co-operation of creditors, trustees, etc.	Useful - for obtaining data to reconcile the different perspectives of different key players
Evaluation of sources of advice and support	None identified	Essential for identifying how steps can be taken to develop diversion strategies from bankruptcy
Action research	Requirement for the project to be very professionally organised, staffed and publicised.	Essential - to establish clearly the benefits of providing appropriate support to businesses in difficulty

7.3 Recommendations

7.3.1 As a result of the scoping study, we would recommend the following way forward.

7.3.2 Firstly, that a statistical analysis of the Register of Insolvencies be undertaken.

7.3.3 Secondly, that statistical data collection on business-related bankruptcies be conducted, through additions to the Supplementary Questionnaire. Once insolvency practitioners had responded to the piloted version of the additional questions, these would need to be amended, and then discussions entered into with the office of the

Accountant in Bankruptcy in order that they can be included in the published version of the Supplementary Questionnaire. The amended version would then be issued to all insolvency practitioners, along with a letter of introduction, and guidelines.

- 7.3.4 Thirdly, that additional research with recently bankrupt people be piloted, including investigation of their business books. Initially, insolvency practitioners, and others, should be approached with a view to forming a working party for the production of criteria for undertaking this investigating and data collection. In addition, insolvency practitioners should be approached to assess their interest in taking part in this research, with the pilot involving use both of insolvency practitioners themselves, and of suitably qualified researchers. Following an evaluation of the pilot, including the advantages and disadvantages of using insolvency practitioners and researchers respectively, the quality of the information being obtained, and its practical utility, it will be possible to form a view on whether all business-related bankruptcies, or only a sample, should be investigated fully. In addition to other aspects of research with the recently bankrupt people, it is recommended that some of these bankruptcies be used as the basis of case studies, involving interviews with their creditors, trustees, and other relevant professionals, as well as the debtor.
- 7.3.5 Fourthly, that a systematic review of services to businesses in difficulty be undertaken, including evaluation of how relevant they are to the needs of businesses.
- 7.3.6 Finally, that discussion of the possibilities for developing one or more action research project for providing support to businesses in difficulty be commenced, these discussions to take place with policy makers, the enterprise network, business-related organisations and potential funders.

Annex A - Glossary of Terms²²

Act and Warrant	A document issued by the court formally vesting a debtor's estate in a permanent trustee.
Accountant in Bankruptcy	A statutory officer appointed by the Secretary of State for Scotland, with four main functions in the administration of bankruptcy: to act as trustee if none is nominated by the petitioner; to perform the role of commissioners if none are elected; to supervise the work of trustees and commissioners and regulate the sequestration process; and to maintain a public Register of Insolvencies. The office of the Accountant in Bankruptcy is an independent department of the Scottish Courts Administration.
Apparent Insolvency	A formal state of insolvency, in which a debtor may be petitioned for sequestration.
Arrestment	A form of diligence whereby funds due to a debtor by a third party (e.g. a bank, a customer) are held for a creditor. The funds can only be released if the debtor grants a mandate, or the creditor obtains a decree of forthcoming from the court.
Assets	Property, including heritable, or immovable, property (land and buildings); moveable property (good, cash, money in banks, investments, etc); money owed to the debtor by others; rights to money or goods in the future; and income from employment, pensions, benefits, etc.
Award (of sequestration)	The court order declaring a person to be bankrupt and sequestrating his/her estate.
Charge for payment	A formal notice served by a sheriff officer, following a decree, which requires the debtor to make payment within a 14-day period.
Commissioner	A creditor elected by the statutory meeting of creditors to supervise the permanent trustee on their behalf.
Court of Session	The highest civil court in Scotland.
Creditor	Any person, business or organisation to whom a debtor owes money.
Debtor	Any person who owes money to another. Can also be used specifically to mean an insolvent person who is subject to sequestration.
Decree for payment	A formal order of the court requiring a debtor to make payment to a creditor.
Diligence	Various legal processes by which a creditor who has obtained a decree and served a charge for payment, or been granted a summary warrant, can pursue a debtor for payment of overdue debts. Diligences include inhibition, arrestment, earnings arrestment, and poinding and warrant sale.

²² This glossary is based on definitions provided in An Introduction to Sequestration, The Accountant in Bankruptcy, and in Understanding Insolvency, Third Edition, issued by the Society of Practitioners of Insolvency (SPI, now renamed R3), 1997.

Discharge	Formal termination of bankruptcy, for a debtor usually 3 years after sequestration; for interim and permanent trustees, when their functions have been completed.
Dividend	The payment made to creditors in a sequestration, in repayment of their debt; the proportion of the total owed which is paid out is expressed in terms of pence in the £.
Earnings arrestment	A form of diligence whereby the debtor's employer deducts a proportion of the debtor's wages (determined by statutory tables) for payment direct to the creditor.
Estate	All property and rights belonging to a person.
Gratuitous alienation	The transfer of property to another person, prior to insolvency, for less than full value.
Inhibition	A legal process whereby a creditor registers an interest in heritable property owned by a debtor, thereby barring the debtor from disposing of the property without discharging the creditor's claim.
Insolvency practitioner	A chartered accountant (or more unusually, a solicitor) qualified and licensed to act as a trustee in sequestrations or trust deeds, and to act as liquidator, administrator or receiver of a limited company.
Interim trustee	An insolvency practitioner appointed by the court to safeguard a debtor's estate pending the election or appointment of a permanent trustee; if an interim trustee is not nominated on the petition the Accountant in Bankruptcy will be appointed.
Permanent trustee	The insolvency practitioner elected by the creditors or appointed by the court, to take possession of the debtor's estate and to realise assets for the benefit of the creditors; if a permanent trustee is not elected by the creditors the Accountant in Bankruptcy will be appointed.
Petition	A formal application to the court.
Poining	(Pronounced <i>pinding</i>) a form of diligence carried out by sheriff officers whereby the debtor's possessions are valued, and may subsequently be removed and sold by auction, at warrant sale. A wide range of household goods is excluded from poining.
Protected trust deed	A trust deed automatically becomes protected if notice of it is served on all creditors, unless the majority of the creditors, or 1/3 rd of creditors (by value of the debt), object in writing. The protected trust deed is binding on all creditors, who may not pursue other debt-recovery procedures.
Register of Insolvencies	A public register recording details of all sequestrations awarded in Scotland. The register also includes details of protected trust deeds.
Sederunt Book	The official and permanent record of the sequestration process maintained by the permanent trustee.
Sequestration	The Scottish legal term for bankruptcy, whereby the insolvent person's estate is removed from his/her control, and transferred to a trustee.

Statutory demand	A formal demand for payment of a debt, issued under oath and requiring payment within 21 days. Failure to pay, or to deny the debt, renders the debtor apparently insolvent.
Statutory meeting	The first meeting of creditors called by the interim trustee for the purposes of electing a permanent trustee and commissioners.
Summary warrant	Granted by the court on application by a government department or local authority for unpaid rates or taxes, a summary warrant can be followed by doing diligence.
Trust deed	A formal, legally binding contract between a trustee and a debtor, entered into voluntarily, under which the trustee administers the debtor's assets for the benefit of his creditors.
Trustee	See interim trustee and permanent trustee.
Unfair preference	A payment made by a debtor to a particular creditor, which prejudices the interests of other creditors.
Vested in	A legal term, meaning to become the property of, as the debtor's assets become the property of the trustee in sequestration.
Warrant to cite	A warrant granted by the court ordering the debtor to appear on the date stated to show that the grounds for the sequestration no longer exist, otherwise the sequestration will be awarded.

Annex B – Interviews Undertaken in the Scoping Study

In addition to telephone interviews, the following in-depth face-to-face interviews were undertaken during the scoping study.

Category	Organisation	No	Total
Policy	Scottish Executive - Civil Law Division	1	1
	Scottish Executive - Courts Division	1	2
	Scottish Executive - Education & Lifelong Learning	1	3
	Scottish Executive - Legal Studies Research Branch	1	4
	Accountant in Bankruptcy	1	5
Business-related organisations	Local Enterprise Company	1	6
	Entrepreneurial Exchange	1	7
Professional Involvement in Bankruptcy	Institute of Chartered Accountants of Scotland	1	8
	Accountant in Bankruptcy - Case Management Branch	1	9
	Accountant in Bankruptcy – Registration & Supervision	1	10
	Insolvency practitioners	6	11-16
	Law Society of Scotland	1	17
	Solicitors	2	18-19
	Sheriff clerk	3	20-22
	Sheriff officer	1	23
Money Advice Organisations	Money Advice Scotland	1	24
	CAB Money Adviser	1	25
Equality Organisations	Ethnic minority organisations	3	26-28
Personal Involvement	Entrepreneurs	2	19-30
	Debtors/bankrupts	12	31-42
	Banks	2	43-44
	Local authority	1	45
	Government departments	2	46-47
	Company	1	48

Annex C – Insolvency / Bankruptcy Literature References

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