

Micro-, Small and Medium-sized Enterprises Day – 27 June 2022

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Introduction

Micro-, Small and Medium-Sized Enterprises (MSMEs) represent the backbone of modern economies across all continents, irrespective of the single countries' development level. This has been the case for as far as we can remember, as micro and small entrepreneurs played a pivotal role in Ancient Rome and even in Medieval times.



According to the Federation of Small Businesses (FSB), a UK organisation representing small and medium-sized businesses, MSMEs¹ make 99.2% of businesses in the country. They account for 99.9% of the business population, 61% of total employment and 52% of turnover in the UK private sector.

The COVID-19 pandemic, the evolution of consumers' demand and the implementation of new technologies have increased insolvency risks for these enterprises, as they are vastly over-represented in hard-hit sectors such as the hospitality and trade industry. High numbers of MSMEs insolvencies and collective redundancies may result in threatening both macroeconomic and social stability.

Despite their economic importance, most jurisdictions around the world treat MSMEs experiencing insolvency or financial distress in the same way as large corporations. However, traditional insolvency procedures can be overly expensive, procedural, long and – ultimately – ineffective for MSMEs. Opportunities to rescue distressed yet viable businesses may be lost. Some countries around the world – and most notably the USA,² Ireland³ and Australia⁴ – have introduced simplified insolvency regimes for MSMEs. Despite the regulatory changes introduced in the wake of the COVID-19 pandemic, the UK has yet to specifically address the issue of the treatment of distressed MSMEs.

¹ IFB describes MSMEs as businesses with up to 49 employees. Different organisations and states adopt different notions on the meaning of "MSME".

² Small Business Reorganization Act of 2019. For a comment, see (among others): W Norton III and J Bailey, 'The Pros and Cons of the Small Business Reorganization Act of 2019' (2020) 36 Emory Bankruptcy Developments Journal 384; A Walters, 'The Small Business Reorganization Act: America's new tool for SME restructuring for the COVID and post-COVID era' (2020) 41(10) Comp. Law. 324.

³ Companies (Rescue Process for Small and Micro Companies) Act 2021. For a comment, see (among others): GB Hutchinson, 'The Small Companies Rescue Act – false hope for failing companies?' (2021) 28(7) C.L. Pract. 122.

⁴ Corporations Amendment (Corporate Insolvency Reforms) Act 2020 (Cth) (Act).

This article summarises the recommendations stemming from reputable international organisations as well as the academic debate in the area to provide some “food-for-thought” for a debate on regulatory reforms in the UK.

International Proposals

The first document to challenge the *status quo* on the treatment of MSMEs in insolvency was the *Report on the Treatment of MSME Insolvency*, published by the **World Bank** in 2017.⁵ The report reviewed and analysed how legislations around the world dealt with MSME insolvencies and considered if international standards should be updated to address in a more tailored way the needs of these enterprises.



The Report concluded that national states should be mindful of the specific challenges faced by MSMEs (as outlined in the report), and they should introduce changes in their legislation to deal with those challenges in an effective and proactive manner. However, the Report fell short of recommending the establishment of separate insolvency regimes applicable only to MSMEs. Importantly, the Report evidenced the need for expeditious and cost-effective liquidation procedures, as well as for alternative resolution mechanisms and investment in the financial education of the company directors.

After just one year, this document was followed by another Report aiming to advance the discussion on MSME insolvency by considering possible proposals for treating the rescue and rehabilitation of MSMEs.⁶ The latter suggests that an optimal MSME insolvency regime, applicable in the broadest range of countries and contexts, should include the following two main components:

- (1) a liquidation-and-discharge regime for natural person entrepreneurs; and
- (2) a simplified, creditor-controlled restructuring regime applicable to both natural and legal persons.

⁵ The World Bank, *Report on the Treatment of MSME Insolvency* (2017), available at: <<https://documents1.worldbank.org/curated/en/973331494264489956/pdf/114823-REVISED-PUBLIC-MSME-Insolvency-report-low-res-final.pdf>> accessed 18 June 2022.

⁶ The World Bank, *Saving Entrepreneurs, Saving Enterprises: Proposals on the Treatment of MSME Insolvency* (2018), available at <<https://documents1.worldbank.org/curated/en/989581537265261393/pdf/Saving-Entrepreneurs-Saving-Enterprises-Proposals-on-the-Treatment-of-MSME-Insolvency.pdf>> accessed 18 June 2022.



Concurrently, the issues faced by MSMEs (including their treatment when insolvent or in financial distress) was being considered in more depth by the United Nations Commission on International Trade Law (**UNCITRAL**). Since 2013, Working Group I started developing a series of rules designed to streamline regulation and registration procedures for these entities. This work resulted in the *UNCITRAL Legislative Guide on Key Principles of a Business Registry* (2019)⁷ and the *UNCITRAL Legislative Recommendations on Limited Liability Enterprises* (2021).⁸ At the same time, Working Group V has been focusing on the needs of micro and small enterprises for a simplified insolvency regime. Its work has resulted in the *UNCITRAL Legislative Recommendations on Insolvency of Micro- and Small Enterprises* (2021),⁹ which basically represent an implementation of the World Bank's recommendations in their last report published in 2018.

The UNCITRAL Insolvency Recommendations assume that most MSMEs are unsophisticated in financial, business management, legal and insolvency matters. They suffer from comparably higher levels of stigmatisation of insolvency situations than large enterprises, and deal with more uncooperative creditors than in liquidation or reorganisation procedures involving larger enterprises. These characteristics result in late filings, very low returns to creditors, and comparably large numbers of disqualification orders against company directors.

As MSMEs need fast, simple, accessible and affordable procedures (known as "simplified insolvency regimes") as well as guidance and assistance on how to use them, the UNCITRAL Insolvency Recommendations suggest that guidance and assistance should be provided before the commencement of insolvency proceedings and throughout the proceedings. The objective is to expeditiously liquidate and discharge non-viable MSEs from debts, while assisting viable MSEs to reach a workable solution with their creditors for a debt restructuring and business and management reorganization. The UNCITRAL Insolvency Recommendations include detailed advice on how these regimes should look like.

So far, the **European Union** has adopted a more prudent approach in providing recommendations on the treatment of MSMEs. While it has promoted a series of initiatives to promote entrepreneurialism,¹⁰ it has not developed specific initiatives targeted at MSME insolvencies because it believes that the UNCITRAL Recommendations for MSMEs are

⁷ Available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/lg_business_registry-e.pdf accessed 18 June 2022.

⁸ Available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/uncitral_legislative_recommendations_on_limited_liability_enterprises.pdf accessed 18 June 2022.

⁹ Available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/part_5_en.pdf accessed 18 June 2022.

¹⁰ For an outline, see here: https://ec.europa.eu/growth/smes_en accessed 18 June 2022.

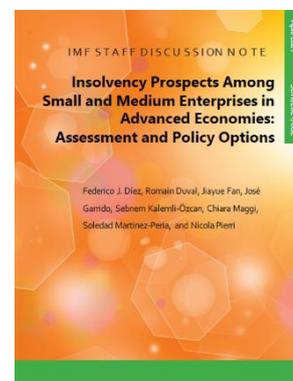
largely in line with the content of the EU Preventive Restructuring Directive.¹¹ Little has been published in the area beyond a study on the impact of the proposed EU preventive restructuring directive on MSMEs.¹²



A similar approach has also been followed by the **Organisation for Economic Co-operation and Development (OECD)**, a forum where the governments of 37 democracies with market-based economies collaborate to develop policy standards to promote sustainable economic growth. Since 2019, the Working Party on SMEs and Entrepreneurship (WPSMEE, now the CMSEE) advanced work towards adopting strategies¹³ to help countries develop coherent, effective and efficient MSME and entrepreneurship policies. In 2021-22, the CMSEE developed through an iterative process a set of guiding principles for SME and entrepreneurship policies. This resulted in the

OECD Recommendation on SME and Entrepreneurial Policy.¹⁴ The main aim of the Recommendation is to promote coherent, effective and efficient SME and entrepreneurship policies, to foster the contribution of these enterprises to inclusive and sustainable growth for the benefit of all. While the pillars on which this Recommendation revolves touch on issues such as governance and financing of MSMEs, no specific provisions deal with the treatment of distressed or insolvent enterprises.

Finally, the **International Monetary Fund (IMF)** addressed the topic of MSME insolvencies most recently in a staff discussion note published on 2 April 2021.¹⁵ On that occasion, the group of experts advocated for a 3-pronged approach to address the difficulties faced by MSMEs post-pandemic: (i) continue equity injections and liquidity



¹¹ Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 OJ L 172/18.

¹² S Madaus, *The Impact on SMEs of the Proposal of Preventive Restructuring, Second Chance and Improvement Measures* (2017) <[https://www.europarl.europa.eu/RegData/etudes/IDAN/2017/583151/IPOL_IDA\(2017\)583151_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/IDAN/2017/583151/IPOL_IDA(2017)583151_EN.pdf)> accessed 18 June 2022.

¹³ <<https://www.oecd.org/cfe/smes/strategy.htm>> accessed 18 June 2022.

¹⁴ <<https://www.oecd.org/cfe/smes/oecdrecommendationonsmeandentrepreneurshipolicy/>> accessed 18 June 2022

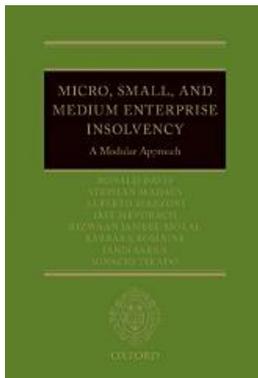
¹⁵ FJ Diéz et al., 'Insolvency Prospects Among Small and Medium Enterprises in Advanced Economies: Assessment and Policy Options' (2 April 2021) SDN/2021/002 <<https://www.imf.org/en/Publications/Staff>

support;¹⁶ (ii) further develop quasi-equity injections through (for instance) “profit participation loans”; and (iii) develop a tailored insolvency and debt restructuring framework. According to the IMF, such framework should include ‘dedicated out-of-court restructuring mechanisms, hybrid restructuring, as well as strengthened reorganization and liquidation procedures, including simplified reorganization procedures for smaller firms’.¹⁷

This high-level analysis of the main policy developments at the international level shows that the UK could draw on the existing reports and recommendations to develop a comprehensive, coherent and effective framework for dealing with MSMEs in distress or in a state of insolvency.

Academic Debate

The regulatory debate has been complimented and at times prompted by the academic literature in the field. Designing an efficient insolvency system has traditionally been the cornerstone of the economic literature on insolvency law.¹⁸ However, the focus has traditionally shifted to the treatment of large corporations.



One of the most influential studies specifically addressed to MSMEs was published as recently as 2018 by a series of leading insolvency scholars.¹⁹ Their book proposes a modular approach for dealing with MSMEs in distress. Such approach would:

- (i) allow national policy makers to choose from a range of available options including in terms of the involvement of appropriate institutions;
- (ii) provide an essential “core” process in each insolvency and restructuring case while allowing relevant stakeholders to invoke additional tools (“modules”) if and when the benefits of wielding those tools in the particular case outweigh the costs.

This and other papers in the field²⁰ evidenced some key elements that must be considered when reforming domestic insolvency and restructuring tools. Besides the need to simplify

[Discussion-Notes/Issues/2021/03/25/Insolvency-Prospects-Among-Small-and-Medium-Sized-Enterprises-in-Advanced-Economies-50138](#)> accessed 18 June 2022.

¹⁶ On this issue, see (among others): M Gray, ‘A tsunami of undesirable debt: the case for an equity solution’ (2021) 18(2) Int. C.R. 134.

¹⁷ Ibid, 9.

¹⁸ For an outline, see (among others): J Armour, ‘The Law and Economics of Corporate Insolvency: A Review’ (2001) ESRC Centre for Business Research, University of Cambridge Working Paper No. 197 <<https://www.cbr.cam.ac.uk/wp-content/uploads/2020/08/wp197.pdf>> accessed 18 June 2022.

¹⁹ RJ Mokal et al., *Micro, Small and Medium Enterprise Insolvency: A Modular Approach* (OUP 2018).

²⁰ See, among others: S Paterson, ‘Debt restructuring and notions of fairness’ (2017) 80(4) M.L.R. 600 (examining how principles of fairness can be applied to small and medium-sized enterprise restructurings); J McCarthy, ‘Challenges in finding the “right” approach to SME rescue: the example of reforms

and render existing mechanisms more efficient, scholars have drawn the attention to the specific funding needs of MSMEs; to the importance of addressing the stigma associated with both insolvency and restructuring procedures; and finally to the close link between personal and corporate MSME insolvencies, as many such corporations may not be incorporated or benefit from separate or limited liability.

One of the most recent academic papers in the field advocates that MSME insolvency and restructuring regimes should be based on 4 pillars:

- (1) promotion of out-of-court restructuring for viable MSMEs facing financial trouble;
- (2) implementation of simplified insolvency processes based on tendering systems;
- (3) introduction of effective discharge of debt mechanisms for honest but unfortunate sole traders or shareholder/manager behind MSMEs;
- (4) adoption of policies and educational programmes designed to reduce the stigma associated with insolvency proceedings.²¹

Conclusion

Besides the company law reforms introduced by the Small Business, Enterprise and Employment Act 2015 (including accelerated strike-off provisions for companies that are no longer operating in the market), and the temporary exemption to the unenforceability of termination clauses against small companies in the Corporate Insolvency and Governance Act 2020, the UK legislator has been notably inactive in promoting reforms in the area of MSME insolvency and restructuring. This is even though many countries around the world have adopted, are currently adopting, or planning to adopt, special insolvency frameworks for MSMEs.

The COVID-19 pandemic has accelerated this trend towards the enactment of special insolvency and restructuring measures for MSMEs, as these enterprises have been particularly badly affected by trade restrictions. Traditional insolvency frameworks have proven inadequate to provide an effective response to MSMEs. It is hoped that the attention drawn on these issues by the [UN Micro-, Small and Medium-sized Enterprises Day](#) may push the UK legislator to consider urgent regulatory reforms – for instance, by tweaks to the framework for Part 26A restructuring plans and liquidation procedures – to accommodate the needs of UK MSMEs.

to the Irish examinership process' (2019) 32(2) *Insol. Int.* 43; W Paterson, 'Insolvency reform trends in developing countries' (2019) 16(5) *Int. C.R.* 293; M Barton et al., 'Financial liquidity and business restructuring in the wake of COVID-19' (2020) 180 *N.L.J.* 11.

²¹ A Gurrea-Martínez, 'Implementing an Insolvency Framework for Micro and Small Firms' (20 October 2020) *International Insolvency Review*, available at <https://ssrn.com/abstract=3715654> or <http://dx.doi.org/10.2139/ssrn.3715654>.