

Corporate Bankruptcy: A Legal and Academic Study

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Abstract-

The business world is often confusing at once we see glorifying firms with exclusive work culture, billions in revenue, and hundreds and thousands of employees and in the moment of time everything is gone, mounting debts, rigorous downsizing, getting out of business, getting sold for pennies on the dollar, what triggers all this? how does this rigorous change occur and how do businesses manage to get out of their debt trap? This paper answers all of these questions through this research, the main focus of this paper is to provide knowledge to the management students in a very concise and simple language to provide perspective about the subject matter.

Keywords- bankruptcy, pennies on the dollar, downsizing, debt trap.

Introduction-

In the past or not so far in the past we have seen many big corporations going out of business maybe because of tough competition, economic distress (referring to the 2008 financial crises, dot com bubble 1995 to 2000, and covid-19 outbreak 2020), or any other financial or non-financial situations, In most of the above scenarios one of the similar things is the corporations being left insolvent or gone “bankrupt”. “Bankruptcy in a corporate term that refers to the legal procedure through which corporations can get off their mounting debt and hire a trustee to who in turn sell the company’s assets or holdings to pay the creditors a portion of debt decided by the court”. In this paper, our main focus would be on simplifying this subject and providing basic knowledge to the young management grads to educate them on the virtue of understanding what triggers corporate bankruptcy.

In today’s time, most corporations are financing their long as well as short-term projects through debt, And this pile of leverage can in turn affect the growth of the economy if the corporations default on this debt so the main thing or the main stigma around corporate bankruptcies is that it happens due to using too much leverage for financing the projects.

Let us discuss terms and definitions that would help us to understand this topic thoroughly, topics like bankruptcy code, bankruptcy estate, exceptions in the bankruptcy estate, and type of bankruptcy proceedings (chapters). Citing- (Lewis, 2018)

1. **Bankruptcy Code-** Bankruptcy code is a statute enacted by the US Congress which along with other sources of law governs bankruptcies in the United States. It provides honest debtors a fresh start that is to grant them relief from certain debts they can’t pay as well as protect their financial interests against harassment by the creditors.
2. **Bankruptcy Estate-** Bankruptcy Estate is created as and when a petition is filed in the bankruptcy court, however, the debtor’s assets are used for the repayment of a percentage of creditors’ claims as well as court proceedings.

3. Exceptions in bankruptcy estate- a. any property that is being acquired by the debtor after filing the petition, b. any article of clothing certain medical equipment and residence of the debtor.
4. Types of bankruptcy proceedings (chapters)- ch-7: Liquidation, ch-11: Reorganization, ch-13: Adjustment of Debt.

Analysis of ch-7 and ch-13 bankruptcy, Citing- (las.org, 2016) -

1. Ch-7 Bankruptcy- According to ch-7, bankruptcy is the legal way to “discharge” debts, Discharge means once the bankruptcy is finished, creditors can’t collect from you. In this form of bankruptcy, any business can just file the bankruptcy, hire a trustee and pay the creditors a percent of the money owed to them by selling our assets.
2. Ch-13 Bankruptcy- It is a payment plan ok’d by the bankruptcy court. You and your lawyer write a suggested payment plan. It lets you pay all or a part of your debts over time. It protects you from being sued and having your belongings taken.

Now we would be looking forward to approaches to predicting corporate bankruptcy-

1. The capital structure analyzing approach to predicting bankruptcy- The capital structure of any company is the optimum mix of its debt and equity.

Capital structure = debt/equity or debt : equity

The capital structure of any company is considered optimum when it is 2:1 i.e., the debt of a company should be or can be double its equity because debt can be very useful when used resourcefully to help save taxes and to increase the credibility of a firm when fully paid.

Numerical Explanation-

Suppose a firm has accumulated equity of \$10,000,000 and they have accumulated debt of \$50,000,000 now in this scenario-

$$\begin{aligned} \text{Debt : Equity} &= \$50,000,000 : \$10,000,000 \\ &= 5:1 \end{aligned}$$

Now in the above numerical, it is visible that the firm has a mounting debt that is 5 times their equity which can result in insolvency if the debts are not cleared or things didn’t go as planned. In the end, the only thing that matters is to raise funds through debt if you have the means to pay them back. The higher the debt higher the chance of Bankruptcy.

2. The Balance Sheet approach- Under this approach we need a little bit of accounting knowledge for understanding how assets and liabilities are recorded and how they affect the business. Let’s first understand what are assets and liabilities.
 - Assets- Asset is anything that puts money in your pocket, for instance, stocks, real estate, and mutual funds these are the assets that put money in our pockets once we acquire them.
 - Liabilities- Liability is anything that takes money out of our pockets, for instance, bank loans, debentures, and non-rental property, all these are the liabilities that take money out of our pockets once we acquire them.

Under this approach, if your Liabilities \geq Assets or we are mounting our debt as and when we are planning to start a new project or for expanding to new markets without checking our pockets or sources of repaying our debt, we are in a position to push ourselves into insolvency or bankruptcy or if not then insolvency.

Literature review-

This paper has been written with the extensive use of secondary data since corporate bankruptcy is an area of corporate governance and finding primary data is very difficult or almost impossible, but the websites through which the collection of data has been possible, citing- (las.org, 2016) (uscourts.gov, n.d.) were unable to provide simple graphical interpretations to the users. The website data was too complex to be studied by beginners and that's the gap this paper is trying to fulfill. Not only this but the research papers being cited here (Bulow & Shoven, 1978) as well as (Lukason & Hoffman, 2014) included complex mathematical as well as financial calculations and equations which are meant for the study of managerial or legal PhD scholars or professors which altogether presents a unique challenge of understanding by management students of early stage, to fill this gap this paper includes very basic graphical and tabular representation of data that have been collected from (uscourts.gov, n.d.) any person with a very basic understanding of statistics and data interpretation would be able to understand what has been concluded through this paper, not only this the websites that have been cited here (investopedia.com, n.d.) and (las.org, 2016) for the explanation of bankruptcy chapters that holds a very important position in explaining the legal aspects of Bankruptcy is chosen with a view to provide very basic knowledge about the bankruptcy chapters in a very clear and simple language. Also, the numerical portion that has been added to explain financial risk and how it is related to bankruptcy is very basic and could prove to be very helpful for understanding what is a capital structure and how it affects a business, students from any field would be able to get an idea about the subject matter.

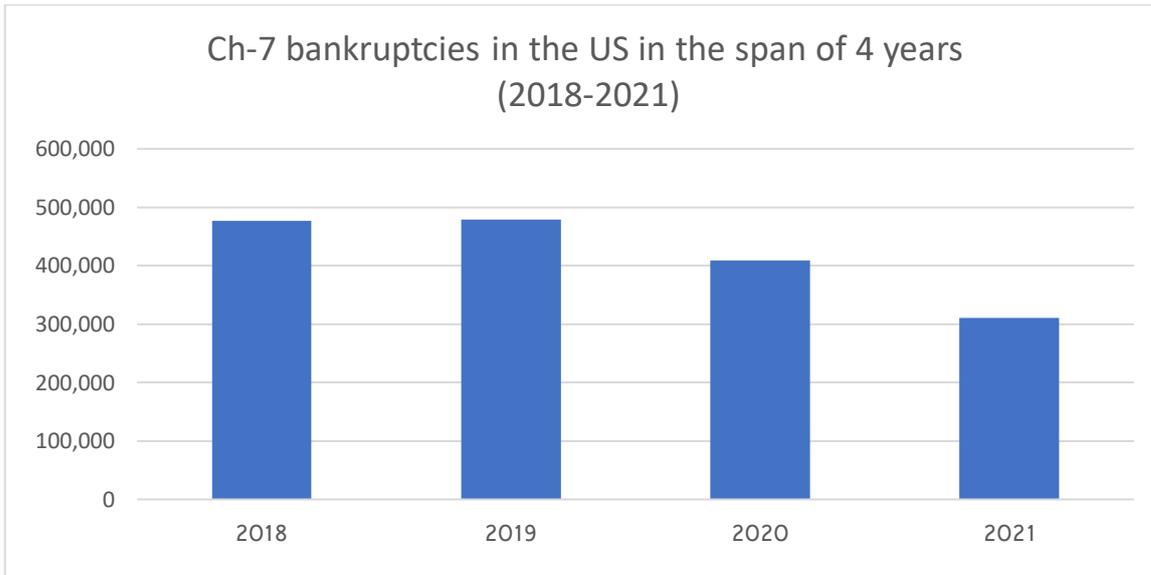
Research Methodology-

In this paper, secondary data has been used from various financial as well as legal-based websites to provide strength and perspective to the research. To represent the data various tabular and graphical methods have been used. To gather the data many govt based legal websites (uscourts.gov, n.d.) have been used, to get relevant data in a structured format also since this is a govt website there are very less chances of biasness, as well as any problems related to the graphs that have been developed and interpreted, are used to gain substantial evidence of the research, other websites that are used to write technical terms based on bankruptcy or any legal or financial topic also are most searched websites across the net which are (investopedia.com, n.d.) (las.org, 2016) as well as the research journals that are being cited in this paper are fact-checked and published many years back and are cited by many people in their respected papers (Lewis, 2018) (Bulow & Shoven, 1978) (Lukason & Hoffman, 2014).

Data and interpretation-

Some data that shows ch-7 bankruptcies in the span of 4 years (2018-2021)citing- (uscourts.gov, n.d.)

Years	Bankruptcy filings
2018	477,248
2019	478,838
2020	409,164
2021	310,597

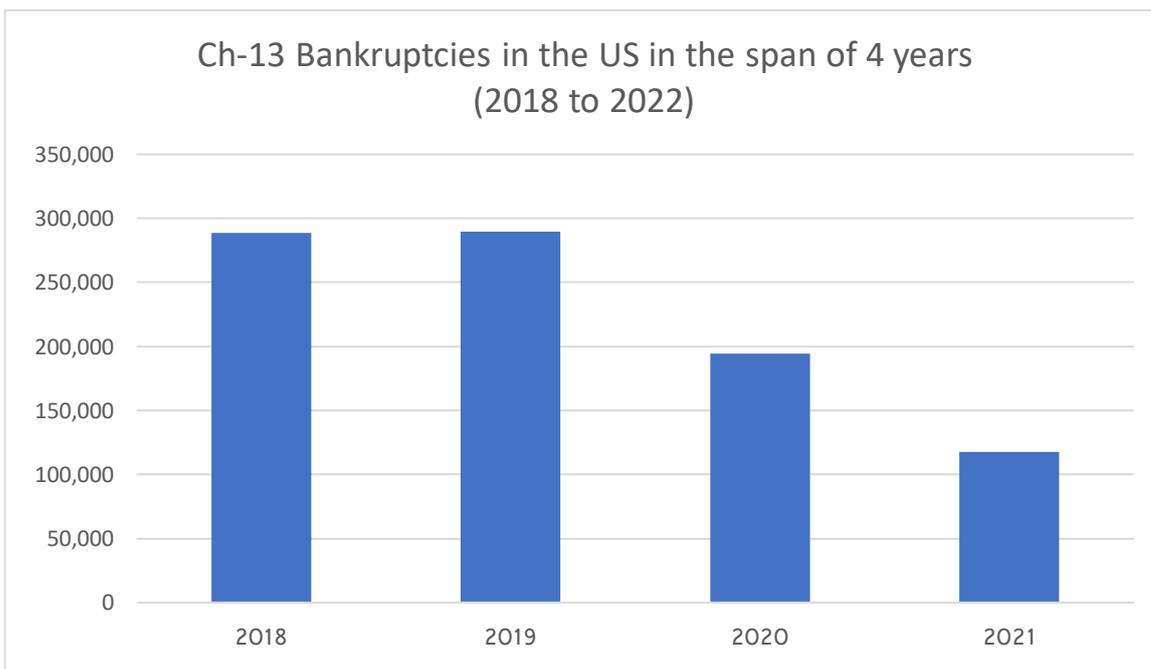


The above graph shows the number of ch-7 bankruptcies filed in the span of 4 years i.e. (2018-2021) and we can see there is a downward tendency from 2018 to 2021.

Some data that shows ch-13 bankruptcies in the span of 4 years (2018-2021)

citing- (uscourts.gov, n.d.)

Years	Bankruptcy filings
2018	288,550
2019	289,802
2020	194,384
2021	117,784

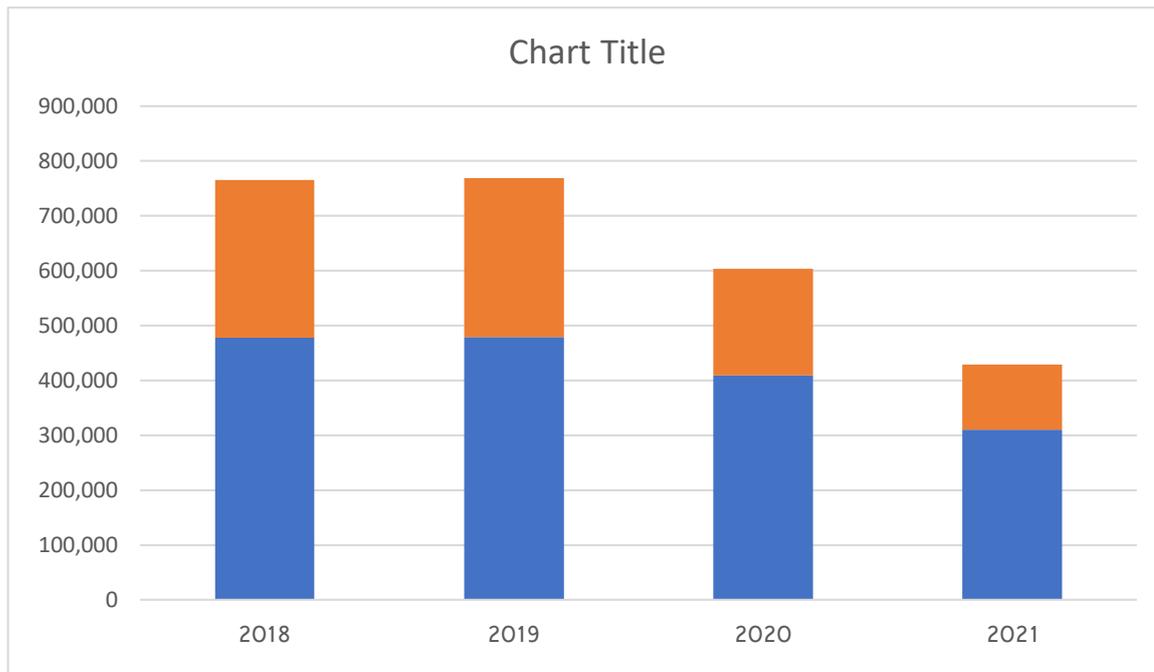


The above graph shows the number of ch-13 bankruptcies filed in the span of 4 years i.e. (2018-2021) and we can see there is a downward tendency from 2018 to 2021.

Some data that shows ch-7 and ch-13 bankruptcies in the span of 4 years (2018-2021)

citing- (uscourts.gov, n.d.)

Years	Ch-7 bankruptcy filings	Ch-13 bankruptcy filings	Total bankruptcies filed
2018	477,248	288,550	765,798
2019	478,838	289,802	768,640
2020	409,164	194,384	603,548
2021	310,597	117,784	428,381



This is a combined chart of both ch-7 and ch-13 bankruptcies filed in the span of 4 years ie (2018-2021) and we can see there is a downward tendency from 2018 to 2021.

Summary-

This paper explains the academic and legal point of view of corporate bankruptcy and how we break down it into different chapters and how we can find out the theory and practical implications of bankruptcy on the economy. The next important aspect of this paper is the analysis and interpretation of the number of corporate bankruptcies filed in 2018-2021, through this paper the main purpose of explaining corporate bankruptcy concepts to managers and legal freshmen from the finance field is sufficed and at the end how this entire corporate world function being legal scrutiny in place how the board of companies function and decision that impact the companies

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