

CORPORATE FAILURE FROM NATIONAL AND REGIONAL PERSPECTIVE IN POLAND

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ABSTRACT

The article deals with the issue of corporate failure in Polish companies from national and regional perspectives. The first part of the work is concerned with legal and economic aspects of bankruptcy. The following part encompasses some record of bankruptcy in Poland viewed from national level as well as regional and industrial ones during economic transformation period.

KEY WORDS

Corporate failure, bankruptcy, liquidity, insolvency, financial condition.

1. Introduction

Corporate failure is usually seen as the most threatening phenomenon that companies face nowadays. It may concern any enterprise irrespectively of its size, profile or managers in charge. Bankruptcy may happen at any time although normally it is preceded by some warning symptoms on strategic and operational levels of the organization that are usually reflected in financial ratios.

Poland as one of ex-socialist countries experienced bankruptcy truly only after the year 1990 when we entered free economy market. It was only then when Polish enterprises had to face competition and became secured no more by the state. Thus, at the beginning of economic transformation numerous companies went bankrupt and their amount drastically rose for a few first years. Despite some insignificant fluctuations the trend was still growing until 2002 when the number of bankrupts reached the top. Since then, there are less bankruptcies recorded.

The article presents some data concerning corporate failure in Poland during the period of transformation. Except for some background information on bankruptcy (both economic and legal), there are some statistics elaborated and concerning corporate failures in Poland on national level. There is also data on provincial and industrial bankruptcies in the considered period.

2. Approaches towards corporate failure

Corporate failure is a kind of phenomenon that can be experienced by economic entities having difficulties with liabilities' payment to another firms [20]. It is very often the last stage in the

whole financial crisis process in any kind of organization.

Economically speaking corporate failure may be defined as the incapability of liabilities' payment together with insufficient assets to pay them off.

Nahotko in his work provides four possible terms that can be included within the notion of corporate failure from financial perspective. He claims these are [12]:

1. insolvency confirmed with legally valid ruling of a commercial court,
2. bankruptcy,
3. loss of payment capacity,
4. outcome of financial and organizational crisis.

Legally speaking the typology of corporate failure is different. Here we can distinguish at least three following senses [12]:

1. depriving the corporate leaders their right to manage the enterprise in favor of official receiver pointed by the court,
2. institution that is aimed at ceasing the debts' growing and lessening their negative effects,
3. kind of forceful performance of debts' payment,
4. execution called universal execution.

There are some ambiguities concerning corporate failure in the literature of the subject. This is due to the fact that the notion seems to be vague and imprecise.

While defining the notion of corporate failure numerous assumptions are made [17]. For instance, a bankrupt or potential bankrupt is the one being in the course of bankruptcy, revival or pact proceedings. Sometimes it is enough to have difficulties with credit repayment like ceasing the charge of interest, abatement or remission of credit, settlement with bank concerning credit repayment, or delay of credit payment deadline. Another reason for being perceived as bankrupt is a simple fact of closing the business, which is definitely an insufficient cause, as liquidation of any enterprise may be performed because of many reasons: private reasons of an owner (voluntary liquidation), market or economic ones [21].

3. Legal environment for corporate failure in Poland

In Poland's legal environment the definition of corporate failure is quite different and a little more

complex as legal corporate failure always must be declared by appropriate Polish commercial court. Legal bankruptcy is an outcome of bankruptcy proceedings that is always started by making bankruptcy motion in the court. Final decision is always made by the court and the motion may be of double origin: made by either the owner (then we talk about so called voluntary bankruptcy) or by creditors (forced bankruptcy). In order to start the proceedings the company needs to gain so called bankruptcy capacity [11]. To gain this, the following circumstances need to occur. Firstly, there should be the lack of paying long-term debts (lack of liquidity is insufficient to declare bankruptcy). Secondly, the value of assets must be lower than the value of liabilities, which explains the incapability of covering the corporate debts [6]. The reasons mentioned above are usually the outcome of some internal reasons (company-dependent) or external ones (company-independent) [7].

It is worth noting that there is no simple relation between the number of motions made in Polish courts and the number of bankruptcy declarations. In other words, only few percentage of cases are decided to declare bankruptcy. It is due to the fact that after the motion is made four variants of legal decisions may occur. These are as follows [14]:

1. declaration of bankruptcy,
2. dismissal of the motion,
3. rejecting of the motion,
4. discontinuation of bankruptcy proceedings.

In the first case the motion is considered positively and it means the end of corporate functioning. In the second case bankruptcy is not declared due to some content-related causes, like the lack of bankruptcy circumstances or disintegrated unit having made the very motion. The motion's rejecting means that it is not admitted because of some formalities not having been completed such as, for instance, incomplete motion, unpaid, without transcripts, unsigned – and after the court's remark they have not been completed. The last possible legal decision is discontinuation of bankruptcy proceedings. It is concerned with the situation in which the proceedings began and in the course of it some circumstances for discontinuation occurred (one may include here the lack of funds to pay judicial expenses).

4. Causes of corporate failure in Poland

Each corporate crisis and bankruptcy are results of some events taking place in internal or external environment of a company. However, the causes for entrepreneurial failure may be different for various economies, as it was in the case of Polish companies. At the beginning of transformation period when bankruptcies were new phenomenon in Poland the causes for them were much different from the reasons of failure in developed countries.

In the nineties the main reasons for corporate failure in Poland were [15]:

- Non-classical causes
 - breaking of current markets which ceased commercial exchange,
 - emerging of new competitive markets with new foreign products,
 - introduction of new stabilization's program which was to stop hyperinflation,
 - inadequate assessment of state companies' adaptation to new economic conditions.
- Classical causes
 - insufficient management quality,
 - improper organizational structures,
 - neglected marketing,
 - neglected financial management.

For firms in developed countries one may cite the following failure causes [16]:

- Internal
 - lack of capital,
 - lack of managerial qualifications and skills,
 - market loss,
 - bad economic condition of a company,
 - lack of liquidity,
 - excessive debt,
 - lack of financial statements,
 - lack of market research,
 - bad management of working capital,
 - increase in bad amount dues,
 - insufficient and incorrect accountancy,
 - speculation,
 - bad location of a company.
- External
 - high interest,
 - increase in competition,
 - family problems,
 - recession,
 - other units' bankruptcy,
 - sales' seasonality,
 - rumors on firm's bad condition,
 - cases in courts.

Comparing the first period after changing the kind of economy in Poland with current economic situation one may say that bankruptcy causes have changed and now they are more like the developed countries' ones. Thus, the main reasons for contemporary Polish enterprises' failure are as follows [16]:

- internal
 - lack of capital,
 - lack of managerial qualifications and skills,
 - lack of financial statements,
 - lack of market research,
 - lack of strategy or vision for companies.
- External
 - high interest rates,
 - fierce competition,

- bribery,
- corruption and funds' misuse.

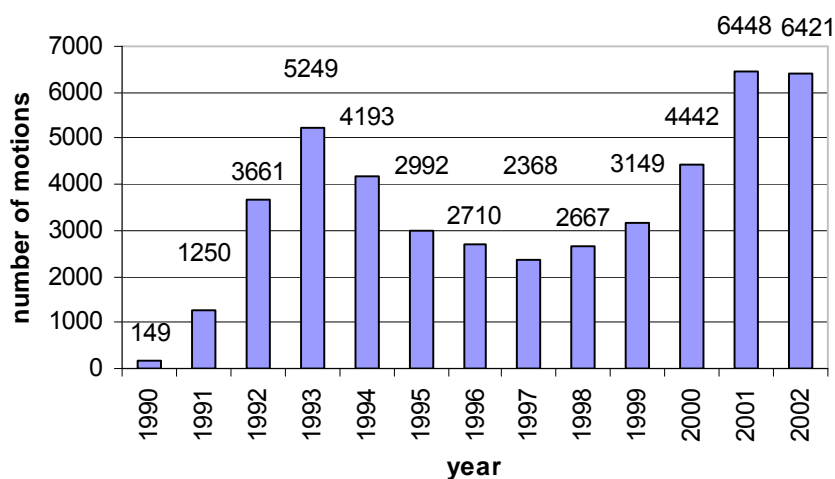
5. Corporate failure in Poland – overall record

After the Second World War until 1990 the property in Poland was in majority owned and managed by the state. Private ventures hardly occurred. In this period we cannot talk about bankruptcies as the state secured all companies even when they were economically ineffective and unproductive. Simply, they were artificially supported and kept going despite their horrifying economic condition. In other words, in the period of centrally planned economy the phenomenon of bankruptcy was hardly known as it never occurred.

After 1990 state property suddenly went private and their owners had to face free market powers. A vast number of them paid the highest price.

In the period 1990-2002 the total number of bankruptcy motions made in Polish courts equaled 45,699. In the first year of transition the number of motions amounted 149. In the following three years they were drastically increasing and in 1993 they reached the number of over 5,000 motions. The next four years we observed gradual decrease in the number of bankruptcy motions as in 1997 there were almost 2,400 motions recorded. Since the moment the trend again changed and almost tripled from 2,667 in 1998 to 6,421 in 2002. The detailed data concerning a number of bankruptcy motions in Poland in 1990-2002 is presented in Chart 1.

Chart 1. Number of bankruptcy motions in Poland in 1990-2002



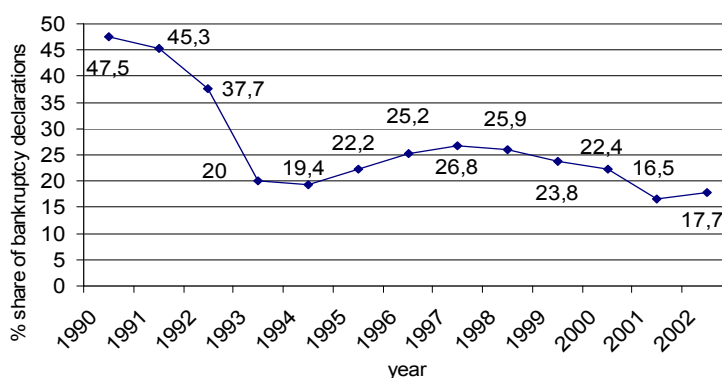
Source: www.ms.gov.pl/statystyki

As previously mentioned not all motions mean that a company will be declared bankrupt. To the contrary, only some part of them ends with bankruptcy declaration. Records prove that with the time, the share of bankruptcy declarations in the number of bankruptcy motions constantly decreases. For instance, in 1990 47.5% of motions

ended with bankruptcy declaration. In 1996, on the other hand, the share almost halved and equaled 25% of all motions. Finally, in 2002 only 17.7% of all motions became bankruptcy declarations.

Detailed data on the share of declarations of failure in the number of bankruptcy motions in 1990-2002 is shown in Chart 2.

Chart 2. The share of bankruptcy declarations in bankruptcy motions in 1990-2002.



Source: www.ms.gov.pl/statystyki

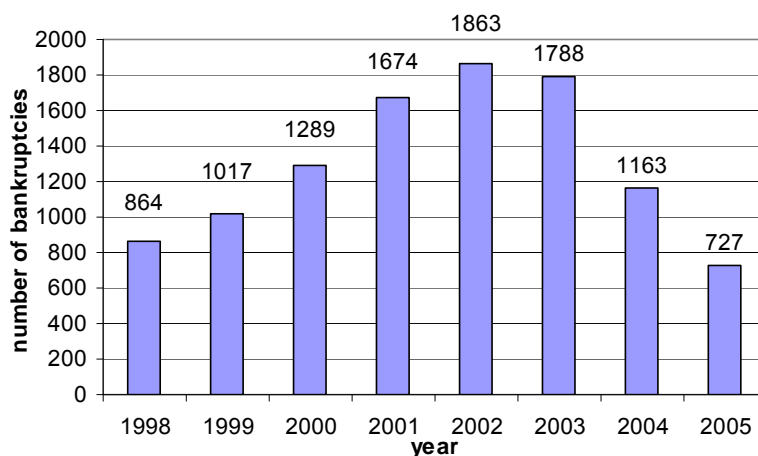
In 2003 Polish bankruptcy law was amended and adapted to the EU standards. This influenced the way of defining bankrupts, as well as the whole procedure of bankruptcy, agreement and recovery process. Since the moment statistics presenting bankruptcy in Poland acquired negative trend and have been decreasing.

In the nineties the number of bankruptcies rose constantly up to 2002, where it reached the top of almost 2000 bankrupts. This was primarily caused by worldwide economic recession that occurred in 2001 and led to the increase in Global Bankruptcy Index. The most difficult period for Polish companies were years 2001-2003. Then the largest number of firms went bankrupt. One can observe significant decrease in number of corporate failures

in 2004; it declined by over 600 if compared to 2003. Next year brought following plunge, this time it almost halved, from 1200 in 2003, to 727 in 2004. The state's situation became more stable and there was an economic growth observed.

According to the latest data provided by Euler Hermes (one of the leaders among commercial credits' insurance companies) the number of bankruptcies is going to decrease in 2006. This is due to the fact that in the first quarter of 2006 only 133 enterprises failed. One shall note that in the same period of 2005 the number of bankrupts was much higher, namely 222 bankrupts. Detailed data concerning number of bankruptcies in Poland in the period 1998-2005 is shown in Chart 3.

Chart 3. Bankruptcies in Poland in 1998-2005



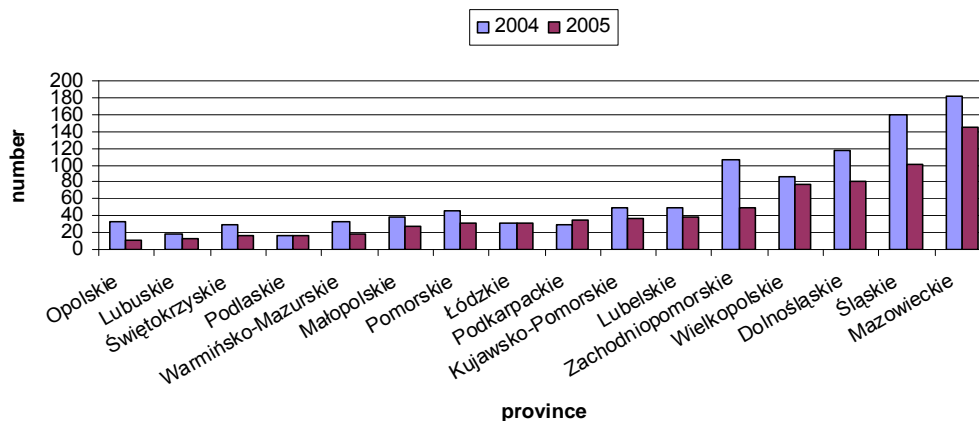
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6. Corporate failure in Poland – spatial and industrial perspectives

Viewing the phenomenon of bankruptcy from spatial perspective one shall note that there are provinces where it is more intense, as well as the ones where it is less significant. The lack of

uniformity is due to the regions' level of development and general number of companies operating in a particular area. The more companies operating, the higher risk of them going bankrupt. The richest region, the more investors are interested in doing business there.

Chart 4. Bankruptcies in Poland in 2004-2005 (provinces)



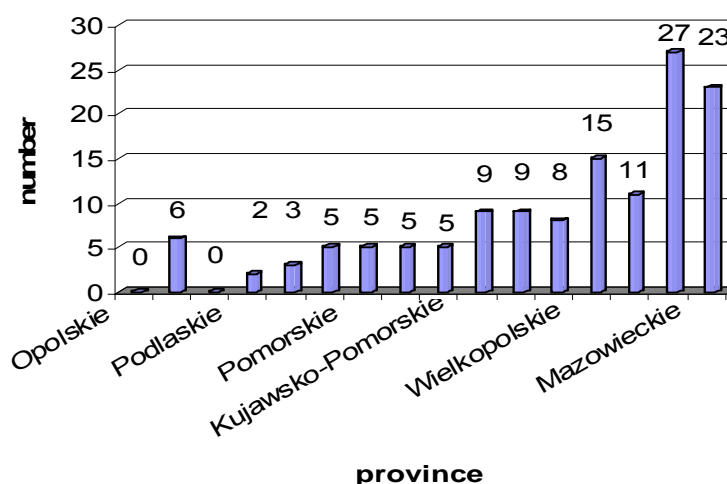
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Bearing all these in mind we can say that the provinces with the largest number of bankruptcies are Mazowieckie Province (central province with Poland's capital Warsaw), Śląskie and Dolnośląskie (two southern provinces involved mainly in heavy industries) which noted in 2004 respectively 181, 159 and 118 bankruptcies. The following year meant respectively 145, 100 and 80 bankrupts. Another province that shows high statistics in this aspect is Wielkopolskie Province which in the first quarter of 2006 outnumbered Dolnośląskie

Province (15 bankruptcies). Let us compare this to 27, 13 and 11 bankruptcies in Mazowieckie, Śląskie and Dolnośląskie Provinces.

The least number of bankruptcies is recorded in Opolskie, Lubuskie and Świętokrzyskie Provinces. In 2004-2005 they experienced only several bankruptcies each year. Detailed data on bankruptcies in Poland with the division into provinces in 2004-2005 and the first quarter of 2006 is displayed respectively in Chart 4 and Chart 5.

Chart 5. Bankruptcies in Poland in the first quarter of 2006 (provinces)

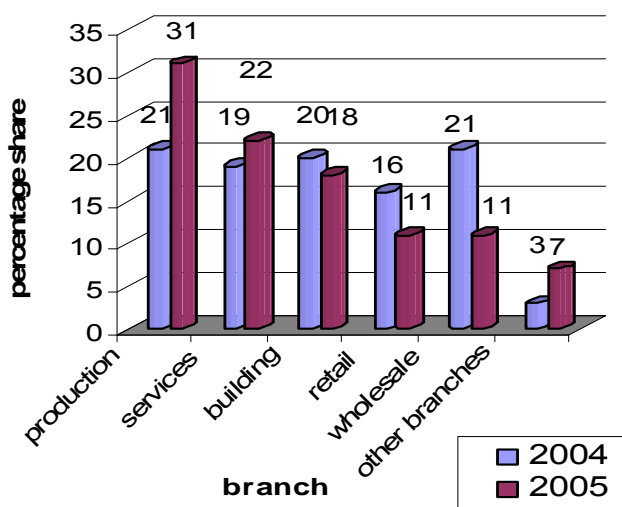


Source: www.egospodarka.pl/article/articleprint/12664/-1/39

Considering bankruptcy phenomenon from branches perspective one shall note that the most endangered industry in Poland is the production industry. Here, the share in the period 2004-2005 is relatively highest and oscillates at 30% level. The trend here presents growing direction, which means

year by year greater amount of production companies failed on Polish market. In 2004 and 2005 their number rose from 21% to 31% share in total number of bankrupt companies. Interestingly, in the first quarter of 2006 the jumping tendency is preserved and reaches the point of 37% share.

Chart 6. Bankruptcies in Poland in 2004-2005 (branches)



Source: www.egospodarka.pl/article/articleprint/10758/-1/39

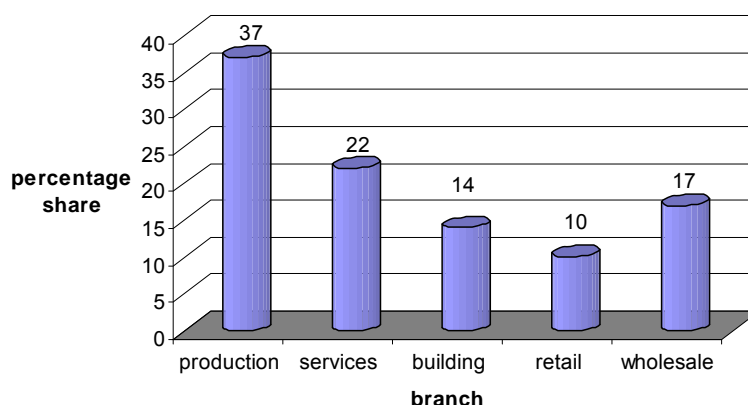
Another hazardous branch on Polish market is service industry. Here, one can also observe growing tendency. Compared with 2004, 2005 noted 3% increase although in the first three months of 2006 there seems no change in the percentage share of service industry.

The third most dangerous branch is building industry with negative trend in the period 2004-2006. It amounted in the three years period respectively 20%, 18% and 14% share.

Interestingly enough the least risky branches in the period 2004-2005 were retail and wholesale industries. In the period under consideration their share significantly declined which means they

became fairly safe for potential investors. If compared with 2004 the percentage share in 2005 for retail decreased by 5% (from 16% to 11%). For the wholesale industry the plunge was even more significant as it almost halved in comparison with 2004 (from 21% in 2004 to 11% in 2005). Although for retail industry the decreasing tendency is kept in the first quarter of 2006 (it stood at the level of 5% share), the wholesale showed diverse, growing trend (from 11% in 2005 to 17% in the beginning of 2006). Details on bankruptcies in Poland in 2004-2006 with the division into branches are presented in Chart 6 and Chart 7.

Chart 7. Bankruptcies in Poland in the first quarter of 2006 (branches)

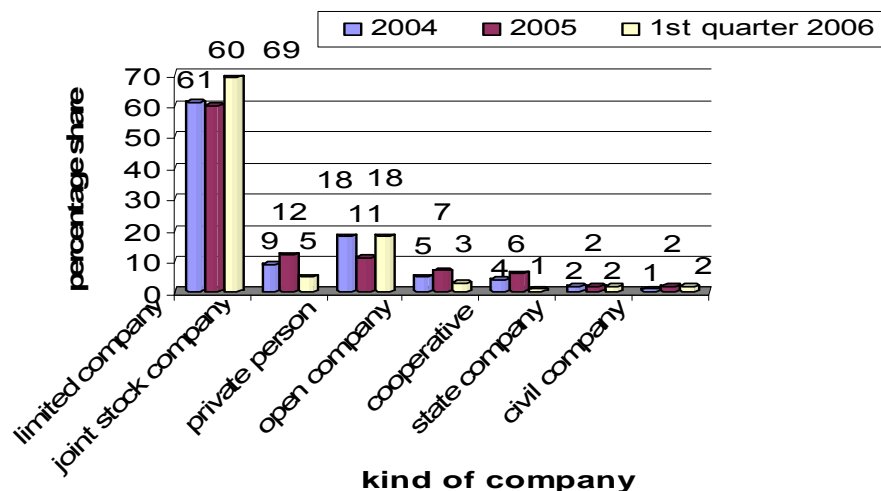


Source: www.egospodarka.pl/article/articleprint/12664/-1/39

According to the newest Polish law concerning legal forms of companies in Poland we can distinguish between several kinds of them. The next issue is concerned with the statistics on bankruptcies in Poland as divided into kinds of company having failed. And here in 2004-2006 the greatest number of bankrupts were limited liability

companies. Their share in the total number of bankrupts ran at the level of around 60%. The beginning of 2006 revealed some growth in the share by 6%, if compared with 2005. This is probably due to the fact that in Poland there are the most enterprises of this kind of legal form.

Chart 8. Bankruptcies in Poland in 2004-2006 (kind of company)



Source: www.egospodarka.pl/article/articleprint/12664/-1/39

The second most significant share is taken by companies established by private units. Their share oscillates from 18% level, even though in 2005 there was a little decrease in the share. Next, the companies with joint-stock come; their share ranged at the considered period from 5% to 12%. The least number of bankrupts is noted among so called civil companies and state companies. They both take around 1-2% each of the total shares. More information on legal forms of Polish companies and their share in bankrupts' statistics is shown in Chart 8.

Summary

The issue of bankruptcy has become an important worldwide point of interest nowadays. Macro-economically speaking it is viewed as a threat for every economy as it leads to some discrepancies on the market. It leads to unemployment and makes the economy less effective. On the other hand, on micro-economic level it may also be perceived as a source of opportunity as newly created company (established on the ground of bankrupt enterprise) may gain success earlier than a newly set company and without costs that are always paid in the beginning of each venture.

Taking into account Poland's case the causes of bankruptcy in the past decade were different from the ones that are valid in this decade. In the first years of economic transformation the main bankruptcy reasons were mostly concerned with the change of property from state-owned to private one, as well as with the fierce competition having occurred on the market (and previously totally unknown to Polish entrepreneurs).

Current causes of bankruptcy in Poland are similar to the causes for developed countries. Here one can cite mismanagement of the organization, its finances and ignorance of external and competitive environment of a firm. Also country-specific bankruptcy factors like bribery, corruption or funds' misuse should be mentioned.

Considering statistics on bankruptcy in Poland in the whole period of transformation one shall note the two stages that can be distinguished here. The first one is the stage from 1990-2002 when the statistics grew drastically from around 100 bankruptcy up to almost 2000 each year. It was due to economic recession that took place worldwide in 2001 that the statistics reached such high peak. However, from 2003 until the very moment Polish economy seems to recover as the GNP constantly grows followed by the decrease in bankruptcies. The most bankruptcies occur in rich central and southern provinces with great number of companies

mostly concerned with building or service industries. The least bankruptcies are observed in poor provinces where companies are less numerous. As far as it comes to branches, the least risky ones have become retail and wholesale industries whose shares in total number of bankruptcies run at the level of a few percentage points.

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