

Micro, Small and Medium Enterprise Insolvency in Africa: a comparative study

Introduction

Ms. Obadi owned a medium-sized sole proprietorship, a Bed and Breakfast inn, in East Africa. It was relatively successful, with a steady stream of foreign tourists, and as it was in a remote region, it employed a number of locals in an area with few jobs. However, following a terrorist attack, the tourism sector suddenly shrank in the country, and severely impacted Ms. Obadi's business. Overwhelmed with business debts, she was left with no choice but to close down. As the Bed and Breakfast was a sole proprietorship, there was no separation between her personal debts and the debts of the business. As is the case in many jurisdictions regarding sole proprietorships, the person and the business were treated as the same entity and were regulated by consumer bankruptcy frameworks—as opposed to incorporated businesses where the emphasis is largely on the survival of the business she put so much effort into. As a result, Ms. Obadi was obliged to file for personal bankruptcy. Due to the fact that there were no efficient attempts to rescue, or at the very least, to efficiently liquidate her ongoing business, Ms. Obadi ultimately lost her home and most of her possessions.¹ This caused her to enter into a spiral of debt from which it would take decades to emerge.

Ms. Obadi's story illustrates the importance of micro, small and medium enterprise (“MSMEs”) insolvency, which, apart from incorporated companies, often comprise unlimited liability partnerships, sole proprietorships or sole traders—the latter are especially abundant in jurisdictions, such as those in Africa, where the informality is high. MSMEs make up the majority of businesses in the world. Although the diversity and sheer number of MSMEs makes it difficult to properly quantify them and measure their impact, they represent the majority of businesses in most jurisdictions and are key drivers of employment, economic growth, and entrepreneurship.² Moreover, economic statistics suggest that small/young firms are the engines of job creation and that, in order for these firms to thrive, entry and, crucially, exit to and from the marketplace must work effectively. Evidence shows that around 20% of these new firms go out of business after their first year and just over 50% after five years. In Africa, the figures are even higher, with obstacles such as constrained access to credit and limited opportunities for firm growth and trade accelerating MSME business failure. In order to encourage the survival of such businesses and in turn promote entrepreneurship, employment and the ability to successfully export,

¹ In this particular case, there was no exemption of the house as one of the assets excluded from personal bankruptcy.

² World Bank Group, Report by the Working Group on the Treatment of MSME Insolvency (2017 - forthcoming)

the domestic insolvency regime needs to be appropriately designed to encourage small business rehabilitation where feasible and fast, efficient liquidation, where rehabilitation is not feasible.

An efficient insolvency system of commercial insolvency (inclusive of both incorporated and unincorporated businesses) must be inspired by the “Insolvency Standard” set by the UNCITRAL Legislative guide³ and the World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes⁴ (jointly, “the Insolvency Standard”⁵). When it comes to insolvency of natural persons, there is no “best practice” and countries have adopted a variety of ways to try to address such a complex issue. A few jurisdictions simply do not have personal insolvency regimes. Other countries differentiate the treatment of natural persons engaged in business activities from those that are merely consumers. Other jurisdictions do not establish such separation, treating both corporate and natural persons under the same insolvency framework. While one of the main objectives of the corporate insolvency system is to maximize the value of the debtor’s estate—including liquidating the company and shutting it down if that provides the highest value to creditors—the same cannot be done with an individual. Many social considerations enter to play when it comes to the treatment of the insolvency of natural persons.

Both UNCITRAL and the World Bank Group are interested in understanding how jurisdictions around the globe are currently dealing with small business insolvency and whether this can inform the creation of best practice principles for MSME insolvency. This paper provides a comparative analysis of how MSME insolvency has been dealt with in some African jurisdictions by assessing two models: (1) applying individual or consumer bankruptcy regimes to address the insolvency of all natural persons, including those engaged in business activities; and (2) applying to those natural persons engaged in business activities a set of simplified and stream-lined insolvency provisions that have been adapted specifically for small businesses and traders by tweaking a more general commercial insolvency framework. In particular, the paper assesses the pros and cons of these models, taking into account issues of particular concern for MSMEs in Africa—such as high levels of informality, the prevalence of micro businesses over larger ones, and the difficulties in accessing credit without immovable collateral. Ultimately, it seeks to provide input for addressing MSME insolvency regulation in a developing country context, as well as more generally contributing to the literature on the importance of MSME firm growth and trade.

The importance of MSME insolvency

MSMEs have several aspects that differentiate them from large corporations when facing a situation of financial distress. MSMEs typically have more issues accessing financing, they are more vulnerable to macroeconomic shocks and they typically fail in larger numbers than big corporations. MSMEs are often times informal and reasonably unsophisticated compared to large limited liability corporations. MSMEs

³ http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2004Guide.html

⁴ <http://documents.worldbank.org/curated/en/557581467990960136/Principles-for-effective-insolvency-and-creditor-debtor-rights-systems>

⁵ As it emerges from the Financial Stability Board’s website, “The ICR Standard is comprised of the World Bank Principles for Effective Insolvency and Creditor Rights Systems (2011) and the Recommendations from the UNCITRAL Legislative Guide on Insolvency Law (2010).” http://www.fsb.org/2011/01/cos_051201/

also have a blurred separation between the ownership and the management of the company, which makes them quite different from large corporations that have robust corporate governance standards and a separation between shareholders and the management body—as well as stricter accountancy regulations. Similarly, there is often confusion when it comes to differentiating between the personal debts and assets of an individual operating an MSME and the debts and assets of the business itself (particularly at times of financial distress). These factors, as well as many others, have a series of natural implications for the insolvency of MSMEs.

In the first place, MSMEs are more reluctant than large corporations to resort to formal insolvency proceedings. This is a product of costs, of access to expert advice and of the owner/manager being overly optimistic that s/he has solutions for all of the company's potential issues. Furthermore, the consequences of several bankruptcy regimes are quite unappealing for small entrepreneurs and can include separation from the administration of the business and, in some cases, even personal prohibitions such as limitations on leaving the country without previous notification or approval of the court in charge of the insolvency process. These factors, among others, contribute to the stigma surrounding the process that disincentivizes MSMEs from seeking judicial arrangements when, perhaps, such a tool could save the business.

Creditors, similarly, have relatively little interest in a typical MSME insolvency proceeding. While the role of creditors in restructuring is paramount, most financial entities (the most common type of creditor in insolvency processes) would have a reasonably limited exposure to each MSMEs and they may have already provisioned the possible loss —depending on the respective country's Central Bank regulation. Finally, secured creditors (including financial institutions) might also be disinterested in the process if they are entitled to proceed with the actions of enforcement.

Another complexity of MSME insolvency is the limited information that the parties can access during the proceeding. As a result of the informality mentioned in the preceding paragraphs, MSMEs' book keeping is generally poor, which results in more challenges at the time of determining the assets of the debtor, the list of creditors, and so on.

Partly due to these factors, MSMEs have limited incentives to resort to insolvency processes to restore their viability. In many jurisdictions, if not the majority, insolvency laws are very complex, require the involvement of many different stakeholders and have a high cost associated with their implementation. These remedies may or may not be adequate to address MSME insolvency—and this is, partly what inspired the current paper.

Why MSME Insolvency in Sub-Saharan Africa

From a technical perspective, the African continent provides an interesting region for examining different approaches to MSME insolvency regulation. Not only are there a large number of countries, many of which are currently reforming their insolvency regimes, but they cover a variety of legal systems including francophone and lusophone civil law, anglophone common law, Roman-Dutch and mixed legal systems. This paper focuses specifically on certain jurisdictions inspired by English common

law (primarily in Southern and East Africa) and some jurisdictions inspired by French civil law (primarily in West Africa).

Secondly, there is evidence that in many African countries, lending to all businesses is perceived as a high risk activity, not only vis-à-vis MSMEs. The most reported reason for this is that formal recovery through the courts is extremely time-consuming and costly.⁶ Financial institutions often attempt to offset this risk by high collateral requirements—predominantly with immovable collateral. However, micro and small businesses are the candidates most likely to fail to meet such collateral requirements and therefore struggle to access capital to start, develop and expand their businesses. Over 50% of MSMEs are reported as struggling to access capital globally.⁷ It is therefore unsurprising that small business failure is high, and developing tools to promote MSME recovery and growth is therefore particularly important in the Sub-Saharan Africa region.

Thirdly, there is traditionally a stigma attached to bankruptcy proceedings. The origin of the word “bankruptcy” is already stigmatic, involving the breaking of the bench of those debtors that were unable to pay their debts. As commercial law evolved in the last quarter of the previous century, the focus began to switch to the economic reason behind the insolvency. This new outlook focused on a non-guilty and non-punitive approach that emphasized the importance of restructuring and keeping businesses as a going concern, keeping entrepreneurs encouraged to continue to innovate, and the like. Not all legislation has been modernized, however. It is still common to find many insolvency laws that maintain the traditional punitive approach and which contributes to the permanence of the stigma—apart from cultural reasons that are even harder to change⁸. In many countries in the African continent, it is still common to find insolvency laws that contemplate imprisonment for a variety of minor business offences such as poor record keeping or for not filing certain statements of affairs verified by affidavits and so on. What is more, there is still widespread acceptance of limitations of personal movement (not being able to leave the country without court permission) in cases of personal bankruptcy.

In order to encourage the survival of small businesses and in turn promote entrepreneurship, employment and the ability to export, the domestic insolvency regime needs to be appropriately designed to encourage small business rehabilitation where feasible, and fast/efficient market exit where in all other cases. The next sections of this paper describe two comparative systems that aim to do this.

Personal Bankruptcy Frameworks Covering Small Business Insolvency Southern and East Africa

Many Roman Dutch legal systems in Southern Africa are influenced by English common law (for instance, South Africa, Zimbabwe, Lesotho and Namibia). Other jurisdictions, in light of their colonial heritage are strongly rooted in English common law, such as Malawi, Zambia, Uganda and Kenya. All of

⁶ World Bank Group assessments.

⁷ <http://www.worldbank.org/en/topic/financialsector/brief/smes-finance>

⁸ An interesting discussion on this topic can be found in the following FT article: <https://www.ft.com/content/d0509a98-78ab-11e5-933d-efcdc3c11c89>

these jurisdictions deal with unincorporated small business debts in the manner described in the introduction—namely there is only one insolvency regime applicable to all natural persons, regardless of whether they were carrying on a business or not. Some of these acts find their inspiration in the UK Insolvency Act of 1986⁹. A small unincorporated business, such as a sole proprietorship, going through insolvency is therefore obliged to use the same personal bankruptcy framework as consumers would and, among other obvious consequences, the insolvency system does not put any emphasis on the survival of the underlying business carried by the natural person. As it is well-known, the objectives of the consumer business regime are not necessarily the same as the ones of business, therefore, some of the consumer solutions applied to an entrepreneur, like the owner of a sole proprietorship, may seem at least theoretically controversial.

In many of the already mentioned jurisdictions under this model, the personal bankruptcy frameworks were, or continue to be, extremely outdated and anachronistic—making them unsuitable for addressing small business distress. Indeed, it is perhaps unsurprising that across the board in these jurisdictions, there were reportedly very few bankruptcy cases, —for individuals or otherwise. For instance, Malawi’s personal insolvency law (prior to its recent reform in 2014) dated from 1928.¹⁰ Although the law did enable an individual to declare his or her intention to present a petition for a declaration of bankruptcy and propose a personal bankruptcy arrangement, there were no requirements for banks to provide notice of impending bankruptcy to customers, nor any counselling services or institutions for administering and regulating Malawi’s personal bankruptcy system.¹¹ In Seychelles, the Bankruptcy and Insolvency Act (prior to its reform in 2013) was originally from 1853, albeit with amendments. In Zambia, the personal insolvency regime is from 1967 and is reportedly rarely used in practice.¹²

Unified Insolvency Law

Many of these countries have recently revised their insolvency regimes, and a trend in the region appears to be putting a unified insolvency law in place. A unified insolvency law is a single statute that covers individuals, unincorporated businesses and corporates, albeit it in different chapters or sections. Such a unified statute has various advantages, including that it is administratively expedient to have all the laws relating to insolvency—for corporates and natural persons alike—in a single statute, and that fragmented legislation in multiple statutes typically causes unnecessary duplication and confusion. Some of the countries that have put a unified insolvency statute in place include: Kenya (2015); Malawi (2014); Mauritius (2009); Seychelles (2013); and Uganda (2011). Lesotho and Zimbabwe are also currently drafting unified insolvency Bills. It is hoped that by replacing out-of-date personal bankruptcy statutes with a more effective personal bankruptcy regime, lender confidence will be increased in lending to MSMEs because the improved insolvency process provides lenders with more certainty and predictability with respect to recovering on defaulted loans.¹³

⁹ <http://www.legislation.gov.uk/ukpga/1986/45/contents/enacted>

¹⁰ Laws of Malawi, Cap. 11:01 of April 14, 1928.

¹¹ World Bank Group, “Malawi: Diagnostic Review of Consumer Protection and Financial Literacy” <http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/MW_CPFL_Vol_II_Final.pdf>

¹² World Bank Group Technical Note, Financial Sector Assessment Program 2016

¹³ The World Bank Group, “Debt Resolution and Business Exit.” Viewpoint, 2014.

Alternatives to Bankruptcy

The countries that have reformed their laws in Southern Africa have tended to include an alternative to bankruptcy in the legal text. This is particularly important when considering distressed MSMEs. These businesses do not have the option to go through a formal restructuring that viable corporates would normally undergo in a corporate insolvency regime. Having said this, given the size of a typical MSME in Southern Africa, it is debatable whether such a formal rescue procedure would really be suitable. Moreover, including such an alternative helps avoid the stigma that bankruptcy proceedings have traditionally carried—particularly in small communities. Allowing businesses to negotiate debt restructuring without losing their reputation maximizes the likelihood of the business being saved, which consequentially makes creditors more likely to extend financing.

Examining the new insolvency laws in Malawi, Seychelles and Zimbabwe, the alternative procedure is the individual voluntary arrangement (IVA), modelled on a similar procedure in the United Kingdom. Procedurally, a natural person debtor (consumer or business owner) enters into an arrangement with his creditors on a voluntary basis, thereby avoiding the disadvantages of being declared formally bankrupt. The procedure is quick and inexpensive, and from the creditors' perspective, increases the likelihood of receiving reasonable returns. In Malawi, the provisions dealing with individual voluntary arrangements also contain a provision allowing for a fast-tracked individual voluntary arrangement. Uganda and Kenya also have similar provisions.

The process itself is quite simple: it permits a debtor to obtain an interim order, whose effect is to temporarily suspend the actions of enforcement against the debtor for a certain period of time (usually, a few weeks¹⁴). In order to be granted the interim order, the debtor has to commit to presenting a proposal of a plan to the creditors in order to achieve an arrangement of her or his debts. Once the creditors' meeting takes place, the proposal is considered therein. Kenya has a few more "divisions" within its legislation which contemplate an even more expedited process and a special division for when a person lacks any assets¹⁵.

Bankruptcy Procedure

Laws such as those in Uganda, Kenya and Seychelles, just to quote a few examples under this model, contain provisions for personal bankruptcy without differentiating consumers from business owners, which would be directly applicable to business owners of an unincorporated entity, such as a sole proprietorship. The bankruptcy process for natural persons contemplated in these jurisdictions begins with a petition that may be filed by both the debtor herself/himself and their relevant creditors, if they meet the requirements indicated in the respective laws. Once the process is initiated, the debtor is publicly examined and required to file an affidavit stating her or his creditors—sometimes under very strict penalties if the debtor fails to do so. If the court adjudges the debtor bankrupt, then an authority (typically, an official receiver or a trustee) is appointed to take custody and control of the debtor's

https://www.wbginvestmentclimate.org/advisory-services/regulatory-simplification/debt-resolution-and-businessexit/upload/VIEWPOINT_343_Debt_Resolution.pdf at 3.

¹⁴ For example, both Uganda (Art. 121) and Kenya (Art. 306 (5)) establish 14 days as the duration of the interim order, giving the court the flexibility to extend it if it deems appropriate.

¹⁵ Division 3, Art. 343 onwards.

estate, among other typical consequences of the insolvency process. All of these provisions are reasonably standard in insolvency systems around the World.

These laws and, generally, laws that fall under this model in Southern and Eastern Africa, contain several provisions and omissions that are relevant for MSME insolvency. In the first place, it is important to notice that most legislations under this model have a provision that exempts certain personal assets from the debtor's insolvency. In this sense, Uganda for example, prevents creditors from attacking the "a) tools, books and other items of equipment which are necessary to the bankruptcy for use personally by him or her in his or her employment, business or vocation of a value to be prescribed; b) [...]"¹⁶ Kenya has a similar provision, authorizing the debtor to keep the "necessary tools of trade"¹⁷, while Seychelles' new insolvency law also has a provision exempting the "tools, books, vehicles and other items of equipment as are necessary to the bankruptcy for use personally by him or her in his or her employment business or vocation up to a maximum value of..."¹⁸. Some other provisions, reasonably typical under this model, impose limits to the debtors' activities. These include limitation that forbid the debtor from taking part in the management or control of any business or to even be employed by any company that is owned or managed by relatives, imposing severe consequences (up to a 2-year imprisonment) in case of contravention¹⁹. These systems generally do not appear to specify that the appointed receiver or trustee needs to have any specific knowledge about the debtors' affairs. It seems possible, if not likely, that in the case of the Bed and Breakfast with which we started the paper, a non-expert (and individual not well versed in the management of such a business) could have been assigned. This seems to be the case precisely because the main stakeholders involved will be more familiar with consumer cases. If the trustee that takes over the administration of Ms. Obadi's estate is inadequate, the likelihood of the business' survival is indeed slimmer²⁰. Managing a business is difficult and managing a business in financial distress, even more so. The incentives of a sole proprietor to resort to proceedings like this, precisely for the reasons above, are also quite doubtful.

Almost all of the jurisdictions have as a final objective a debtor's "discharge" by which, given certain requirements, the debtor would be released from her/his obligations in the future. The notion of "discharge" is widely accepted in comparative jurisdictions and it is generally agreed that the notion of discharge is essential for debtors to continue to contribute to the economy after an insolvency process. Some of these legislations determine that the discharge is obtained by the mere passage of time²¹, however, some others leave the discharge to the discretion of the court after hearing the official receiver—making it possible that a debtor's future income is destined to remain committed to the repayment of the old debts, seemingly, for an indefinite period of time²².

¹⁶ Art 31 Uganda's insolvency law (2011).

¹⁷ Art. 161 (2) Kenya Insolvency Act (2015).

¹⁸ Art. 28 (2) Seychelles insolvency act (2013)

¹⁹ Art 152 Kenya Insolvency Act (2015).

²⁰ Some legislations contemplate the possibility for the trustee to "allow the bankrupt to continue to manage the estate or part of it" (i.e. Uganda's law, Art. 34), but this is a faculty of the trustee, and by no means an obligation.

²¹ Kenya Insolvency Act (2015), Art. 254

²² See, for example, Uganda's law Art. 42. (3).

Under this model, none of the personal insolvency laws reviewed appears to require either the trustee or the court, in cases of a sole proprietorship or for a trader, to attempt to maintain the business as a going concern. This invites reflection upon whether these regulations are suitable (or not) for the particular case of unincorporated MSMEs.

Bespoke Frameworks for Small Business Insolvency: West Africa

The Organization for the Harmonization of Business Laws in Africa (OHADA) comprises seventeen West African States that predominantly are francophone with civil law legal systems. OHADA recently adopted a revised uniform insolvency law that is directly applicable on all member state jurisdictions. Among other reforms, the law provides for the new simplified regulation of MSMEs. Developed in recognition of the fact that most businesses in the OHADA region are small-scale and that the longer it takes to address their financial distress, the less likely it is that there will be a possibility to recover any assets. These appear to be the first insolvency provisions in Africa that have been specifically designed for small businesses and it will be interesting to monitor how successfully they address MSME insolvency.

The OHADA insolvency law differs from the previously described Roman-Dutch/common law jurisdictions insofar as the scope of the insolvency law specifically includes small businesses and natural person owners of unincorporated businesses. It states that it is applicable to every natural person undertaking an independent professional, civil, commercial, artisanal or agricultural activity, as well as every legal person in private law, including public enterprises.²³ The OHADA states ultimately agreed that in the context of their diverse member state economies, a “small business” would constitute a proprietorship, partnership or other natural or legal person having less than or equal to 20 employees and a turnover not exceeding 50 million francs CFA (around US\$80,000) in the 12 months prior to proceedings.²⁴ Moreover, these MSMEs have the option to select simplified proceedings, but are not obliged to do so.²⁵ This provision was to ensure that due process was retained and businesses could retain the option to go through more extensive judicial procedures if they deemed it necessary.

The simplified proceedings apply to three of the four procedures set out in the law, namely *règlement préventif* (preventive settlement); *redressement judiciaire* (reorganization) and *liquidation des biens* (liquidation). They are simplified insofar as many of the formalities related to the filings or hearings are no longer necessary, in order to facilitate faster processes.

Règlement Préventif (Preventive Settlement)

The simplified provisions for *règlement préventif* or preventive settlement, are in the form of derogations from the ‘main’ or overall *règlement préventif* proceeding. They provide that any small business conforming to the definition (set out above) may open proceedings before they are in a state of insolvency. The filing requirements are simplified. For instance, the procedure can be opened even if no plan or arrangement has been provided, and although documents demonstrating the financial

²³ Article

²⁴ Article 1-3

²⁵ Article 1-2

situation of the small business need to be filed, these do not need to be audited and comprehensive financial statements or cash-flow statements are not needed as they are with the general proceeding.²⁶ In the event that any other documents required to be submitted cannot be provided, or can only be provided incompletely, the request must indicate the reason for their absence. As stated above, the debtor may request that the simplified procedure should not be applied and that regular proceedings are instead opened. The decision of the competent court to apply the simplified procedure is not subject to appeal. The simplified procedure also imposes shorter timeframes compared to the general procedure, for instance, regarding the administrator's obligation to file the report containing the agreement between the debtor and its creditors (2 months since the opening of proceedings instead of the regular 3, with a possible extension of 15 days instead of 1 month). The restructuring plan is required to be prepared by the debtor with the assistance of the administrator and can have more simplified content than the plan under the general proceeding.

Redressement judiciaire (reorganization)

As with preventive settlement, the form of simplified reorganization proceedings is a derogation from the general reorganization process.²⁷ As with the general proceeding, the filing must be made by an insolvent debtor within 30 days of insolvency (using the cash-flow test), but with fewer documents required and must be accompanied by a sworn statement attesting that it meets the conditions of a simplified reorganization. The reorganization plan must be filed, with the assistance of an administrator, within 45 days of the declaration of insolvency.²⁸ Unlike the more detailed reorganization plan in the general reorganization process, in the simplified proceeding, the plan may be limited to payment terms, debt relief and the possible guarantees that the entrepreneur must make to ensure its execution. The financial statements and economic records are not required to be submitted alongside the simplified reorganization plan.²⁹ The court can decide to convert a general reorganization to a simplified reorganization within 30 days of opening the proceedings following representations from the administrator.³⁰ At the request of the debtor or administrator, the court can decide not to follow the simplified reorganization process.

Liquidation des biens (liquidation)

The conditions for opening the simplified liquidation are the same as reorganization. As well as meeting the definition of small business, however, there is an additional condition that the debtor does not own any immovable property. A sworn statement must be submitted attesting that the debtor meets the relevant conditions for a simplified liquidation proceeding. After the opening of a liquidation process, the liquidator may, within thirty days of his appointment, prepare and file a report with the competent court. On the basis of this report, the court may apply a simplified liquidation procedure after having heard or summoned the debtor. The court has the right to refuse to apply the simplified liquidation

²⁶ Article 6-1

²⁷ Article 145-1

²⁸ Article 145-3

²⁹ Article 145-4

³⁰ Article 145-5

proceedings, even if the relevant conditions are met. Unlike with the general liquidation proceeding, the court may determine that the sale of the debtor's property should be a private sale agreement.

Comparative Assessment

At this stage, it is difficult to assess which insolvency regime is most effective for MSMEs. Very little data has been collected with respect to common law systems in order to understand whether small businesses have been effectively rescued using tools such as IVAs. The OHADA provisions are too new and have not been implemented yet in all applicable countries, so it is similarly difficult to know if they will be used on a wide-scale basis.

Business debts are treated as distinct from consumer debts

Although many of the goals of consumer and business insolvency are similar, there are a few areas where these objectives are not necessarily aligned. The treatment of a natural persons' insolvency when they are engaged in business activities together with consumer insolvency may end up having a detrimental effect if the result is to disregard the importance of maintaining and maximizing the possible value of the business that the person managed to build. The opposite is also true: Treating small unincorporated traders as large corporations may have the opposite unfair effect, which is to impose extremely complex, lengthy and costly procedures to a small trader that is not sophisticated and most certainly not incentivized to resort to such procedures.

An added layer of complexity to this matter is that distinguishing between the personal and business debts of a natural person can be extremely challenging, as identified in the UNCITRAL Legislative Guide³¹, which may make it extremely complex to attempt to trace a distinction solely on that basis. It seems that, at least from a theoretical point of view, a regime that deals specifically with MSMEs without forgetting the human qualities of the entrepreneurs (i.e. by contemplating a "discharge", for example) may be a positive solution to these types of problems.

Business debts are a product of the market, and there is accordingly a strong rationale for treating them purely with economic concerns and efficient market functioning policies in mind; whereas consumer insolvency raises many other social considerations that policy-makers might want to consider. This is not to say that traders or entrepreneurs should not be afforded certain protections or incentives in an insolvency regime, but rather that governments might be interested in drawing a line between the treatment of debts incurred whilst in the course of commercial activity and those incurred in non-business dealings.

Both "models" mentioned above capture to some extent some of these positive and negative aspects. The OHADA model seems to focus more on the business aspects of the entrepreneur, in an attempt to achieve a higher survival rate of businesses as a going concern. The Southern and Eastern African model seem to focus more on the entrepreneur as a natural person and, therefore, on the possibilities of

³¹ "...it is often difficult to separate an individual's personal indebtedness from their business indebtedness for the purposes of determining how they should be treated in insolvency. Different tests may be developed to facilitate that determination, by focusing, for example, upon the nature of the activity being undertaken, the level of debt and the connection between the debt and the economic activity." UNCITRAL Legislative Guide, page 39.

obtaining a discharge—however, with less regard to rescue or sale of an individual’s business as a going concern.

The focus on fast and cheap insolvency proceedings is an important consideration

All businesses are deterred by the prospect of lengthy and often costly legal proceedings, and this becomes an even bigger obstacle for smaller businesses. Creditors also suffer as a result of lengthy proceedings, with value continuing to leach from the debtor’s estate and minimizing creditor recovery. The World Bank Group *Doing Business Report 2017* reports that it takes around 3 years to complete insolvency proceedings in Sub-Saharan Africa with an average of 20 cents on the dollar ultimately recovered by creditors.³² In comparison, in OECD High Income countries, it reportedly takes 1.7 years on average to undergo insolvency proceedings, with creditor recovery being around 73 cents on the dollar.³³ Given the size of an average MSME in Africa, reportedly between 1-9 people,³⁴ it is highly unlikely that any value would be left for creditors after such lengthy liquidation proceedings—let alone the possibility of saving the business. The OHADA Insolvency Law is therefore theoretically appealing insofar as it cuts a lot of procedural steps that might not be needed for MSMEs of the size contemplated by that law. Moreover, by allowing the fast-track MSME procedures to be optional, the OHADA insolvency law protects those who are concerned that due process might not be followed, or alternatively, those businesses that have more complex cases and deem it necessary to have additional hearings and judicial oversight. The Southern and Eastern African model may also present an alternative for expedited proceedings, given that the natural person insolvency procedure looks more simple than that for corporations. In the end, the success of both models will largely depend on the specialization of the courts and stakeholders involved in the application of these laws.

Pre-insolvency procedures are being increasingly recognized as important, particularly for MSMEs

The recent Regulation (EU) 2015/848 of the European Parliament and of the Council (May 2015) emphasized the importance of pre-insolvency procedures for encouraging business rescue and enabling entrepreneurship. In this sense, IVAs, may be considered effective pre-insolvency procedures and the same can be said about the preventive settlement procedure in the OHADA insolvency law—which is opened, monitored and closed by a judge.³⁵ Particularly in many African countries, where there are concerns regarding transparency and problems of enforcement, this added institutional force behind the agreed arrangement might encourage the parties to trust and accordingly use the procedure before the business is in a state of insolvency. Of course, the down-side is that this procedure is court-based and therefore public, but there is an additional procedure in the insolvency law which covers contractual

³² <<http://www.doingbusiness.org/data/exploretopics/resolving-insolvency>>

³³ Ibid.

³⁴ African Research Associates

³⁵ Note, for a pure out-of-court and confidential procedure, the OHADA law provides for conciliation, which is open to all businesses, regardless of size.

conciliation.³⁶ Another downside is that when the transparency issues affect, precisely, the courts, then the court procedure may not be an advantage for the parties.

In spite of these advancements, there are still areas that are sorely lacking in many African insolvency regimes, which will need to be addressed in order to truly provide an effective insolvency regime for MSMEs. Two examples are as follows: first, most MSMEs in Africa are micro entities operating in the informal sector. It is therefore highly unlikely that any of them will start insolvency proceedings. Secondly, there is a serious lack of financial literacy amongst many entrepreneurs on the continent and access to debt counselling advice is often difficult.

Conclusion

This analysis aims to highlight the importance of MSMEs in African economies, and why insolvency regimes play an important role in ensuring the success of these enterprises. It examines two different methods for handling small business insolvency in various African jurisdictions. Namely, personal bankruptcy regimes that cover natural person insolvency including both consumers and unincorporated enterprises, and insolvency provisions that are simplified from the main commercial insolvency procedure and are applied to certain trade debts (including sole proprietorships). This paper acknowledges that there is currently a lack of data and existing empirical evidence to assess, beyond theoretical considerations, which model is preferable to address MSME insolvency in the regions highlighted in Africa. Moreover, the paper also acknowledges that there are key problems that MSMEs face in Africa that are not addressed by either insolvency regimes, which will continue to impede business start-ups, access to credit and creditor recovery. As stated in the IMF's Regional Economic Outlook for Sub-Saharan Africa, "Over the next 20 years...Sub-Saharan Africa will become the main source of new entrants into the global labor force." It is accordingly crucial that governments have put supporting legislative frameworks in place to support both the entry, restructuring and exit of these businesses, particularly MSME entrepreneurs.

³⁶ As well as reglement preventif, the OHADA insolvency law has a pre-insolvency contractually negotiated arrangement called conciliation.