IJBR, Volume 16, Number 2, 2016 ISSN: 1555-1296

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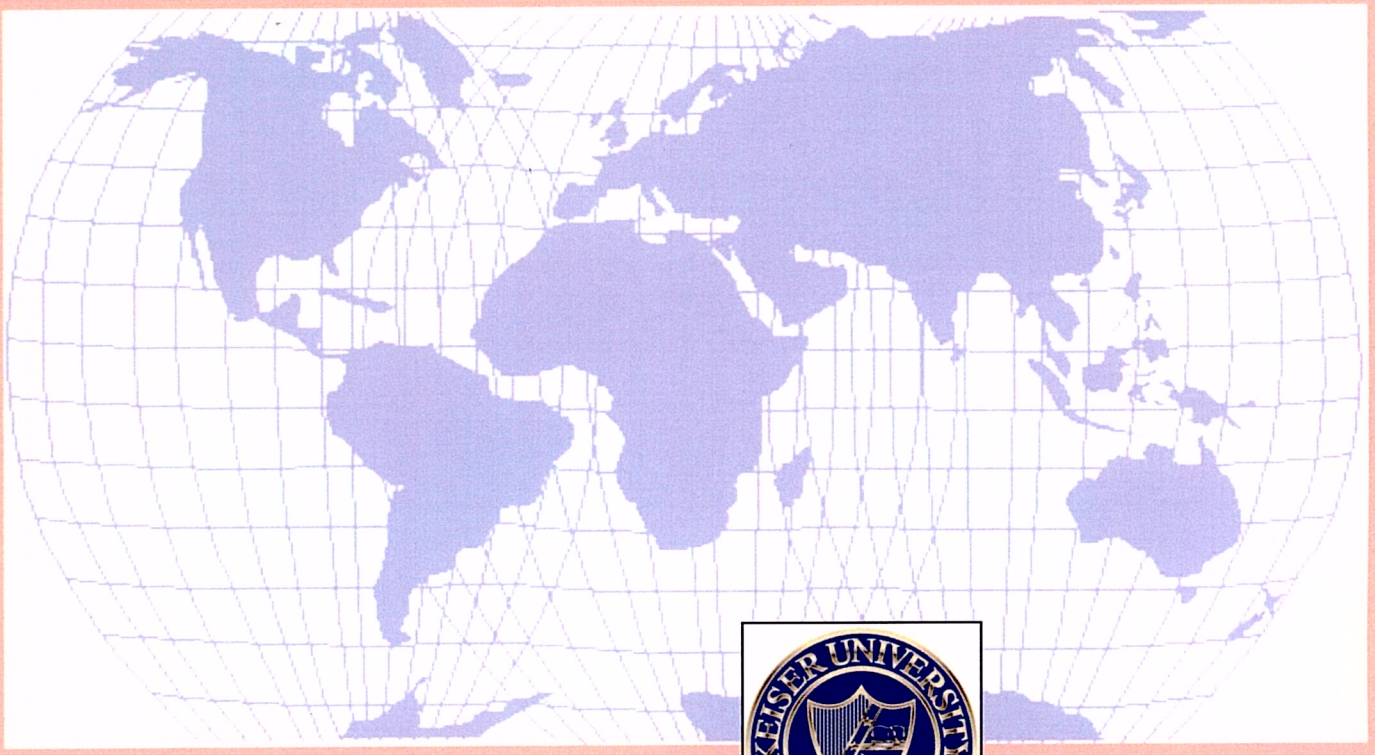

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Timothy Mantz,

DBA, Dean School of Business, Associate Dean of the Graduate School, Keiser University

Editor-In-Chief

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# PAC (PREVENTIVE ARRANGEMENT WITH CREDITORS): A TOOL TO SAFEGUARD THE ENTERPRISE VALUE.

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**ABSTRACT:**

*Italian Insolvency Law has been widely reformed since 2005 in order to introduce new legal procedures aimed at preserving troubled companies, discerning viable from irredeemable businesses, and increasing productivity through a more efficient management of insolvency proceedings. The excessive duration of bankruptcy cases was repeatedly brought to the attention of the European Court of Human Rights, relating to the right to a fair trial in terms of reasonable duration. After the reform, the Preventive Arrangement with Creditors (Concordato Preventivo) became Italy's equivalent of US's Chapter 11 and can be considered the main instrument used by small and medium-sized companies (and sometimes large ones) to manage insolvency by avoiding bankruptcy. This paper provides an empirical analysis on filing of Preventive Arrangements with Creditors in the Court of Milan, one of the largest courts in Italy, in the 2005-2014 period. Through the exam of 720 cases, 60% of the total number, the research shows the different features of the procedure, analyzes the characteristics of companies that resort to it and its diverse purposes of liquidation or restructuring. Due largely to the newness of the legislation, along with the complexity of the Italian system, it is rather difficult to generalize conclusions. Nevertheless, the paper shows how Preventive Arrangements with Creditors can be considered a more efficient instrument than the alternative bankruptcy, both in terms of timeframe as well as with creditors' satisfaction. As part of the overall European reform process of insolvency proceedings, following the 2014 Recommendation issued by the European Commission, Italy seems to provide useful insights for other countries in Europe.*

**Keywords:** *Turnaround, Enterprise value, Preventive Arrangement with Creditors*, *Restructuring, Bankruptcy, Insolvency.*

## 1. INTRODUCTION

Among the so-called "minor" insolvency proceedings, following the reform which Italian Insolvency law underwent, the "*Concordato Preventivo*" or Preventive Arrangement with Creditors (PAC) has assumed the role of main instrument for company recovery and turnaround becoming Italy's equivalent of US's Chapter 11. The excessive duration of bankruptcy cases was repeatedly brought to the attention of the European Court of Human Rights, relating to the right to a fair trial in terms of reasonable duration. Regulatory reviews show how the actual use of this procedure has resulted in an alternative instrument to bankruptcy, mainly through the considerable freedom of initiative granted to the debtor. It is the debtor, in fact, who decides when and how to perform the company's restructuring. The system, created by Insolvency Law (IL), Royal Decree no. 267/1942, has been extensively revised since 2005 because of its inadequacy compared to the current socio-economic reality and following EU Recommendation no. 135/2014.

With regard to the PAC, legislative adjustments include recent Decree Law 83/2015 "Urgent measures on bankruptcy, civil procedure, judicial organization and administration" converted into Law no. 132/2015. The dynamic nature of the procedure, sometimes disharmonic compared to its original formulation, resulted in years of doctrinal legal papers and studies (Panzani, 2009), while economic analysis on the topic have been less recurrent (Danovi, 2003, Falini, 2008; Riva and Provasi, 2013; Danovi, 2014; Riva and Provasi, 2014, Riva and Provasi, 2016). After regulatory reviews, PAC has become a useful tool to avoid bankruptcy, mainly through the considerable freedom granted to the debtor (Lo Cascio, 2015). Now

it is up to the debtor to decide timing and modalities of the company's restructuring plan. The role of creditors and of the Court becomes therefore residual, as the Court confirms or rejects the proposal subject to the approval of creditors.

In this context and in view of the upcoming further reform, it is significant to review the empirical use of the instrument over the past decade. As we will illustrate, after the IL reform and the post-2008 crisis, there has been an unprecedented growing number of PACs in all Italian courts. Nevertheless, there are significant doubts about the real effectiveness of the instrument in terms of restructuring and some concern about its possible opportunistic use.

This paper provides an empirical analysis on filing of Preventive Arrangements with Creditors in the Court of Milan, one of the largest court in Italy, in the 2005-2014 period. Through the exam of 720 cases, 60% of the total number, the research shows the different features of the procedure, analyzes the characteristics of company that resorts to it and its diverse purposes of liquidation or restructuring. Due largely to the newness of the legislation, along with the complexity of the Italian system and considering the limit of studying a significant but geographically concentrated sample, it is rather difficult to generalize conclusions. Nevertheless, the paper shows how PACs can be considered a more efficient instrument than the alternative bankruptcy, both in terms of timeframe as well as with creditors‘ satisfaction. As part of the overall European reform process of insolvency proceedings, following the 2014 Recommendation issued by the European Commission, Italy seems to provide useful insights for other countries in Europe.

## 2. LITERATURE REVIEW

The starting point is to ascertain creditors’ rational choice to adhere to a Preventive Arrangements with Creditors rather than vote for a debt restructuring agreement or a liquidatory procedure. As per Asquith *et al*. (1991), a distressed company and its creditors face two choices: restructure or liquidate. In order to assess whether a PAC is effective, it is necessary to understand whether the cost and benefit analysis leans towards this more than other insolvency procedures.

Understanding whether a factor may influence the success of the recovery process and the probability of Court’s validation can be interesting for practitioners and for creditors. For this purpose, the analysis of the different features of the procedure along with the characteristics of companies is pivotal.

As previously stated, depending on how grave the crisis is, a preventive arrangement will be preferred to restructuring agreements. According to Gertner and Scharfstein (1991), the distinction between a business in financial crisis and an operating one is not always evident: the former can be characterised by positive operating margins but excessive debt, while the latter can be characterised by negative operating margins, though the effects on the bottom line can be quite similar.

Consistent with this view, Couwenberg and de Jong (2004) studied the links between companies in difficulty and their creditor banks. They conclude that, on average, banks are inclined to assist companies in a selective way and those companies willing to undertake organizational and operational changes have a lower probability of going bankrupt. On the other hand Asquith, Gertner and Scharfstein (1991) registered a scarce tendency for banks to provide new finance or to forebear outstanding debt in an extrajudicial procedure, but rather to require protection provided by the Court, i.e. pre-deductibility and suspension of clawback action, in order to provide new financing.

In a going-concern scenario, the involvement of all creditors is critical. Couwenberg and de Jong (2004) highlighted the free-riding problem of trade creditors, especially for those with small exposures, in harsh systems, namely those where creditors have more guarantees under Court protection, which leads to an increase in the rigidity of negotiations by banks and financial creditors.

Two studies, analysing the exposure of trade creditors in financial distress, found an average increase in the exposures during restructurings. Petersen and Rajan (1997) explained it with information asymmetry

which is favourable to trade creditors rather than to banks, given personal relationships with the distressed entrepreneur. Franks and Sussman (2003) highlighted the dependency link between trade creditors and large companies as the increase in creditor's exposure lies more in a lack of alternatives, rather than in an attempt to recover the credit (Available data and the scope of this research do not allow analyzing in such in-depth the link between creditors and distressed debtor, but the presence or absence of trade creditors adherent to the Plan is evident, together with the amount of their credit and of revolving facilities). Gilson, John and Lang (1990) further assessed a negative relationship between the probability of success of a restructuring and the relative amount of debt owed to trade creditors, explained by the difficulty in obtaining unanimous consent on the plan.

The capital structure of the company, together with the number of creditor banks involved, is universally recognized as determinant for the success of a plan. This information can also be used as a proxy of banks' ability to cope with complexity, a variable this latter not directly observable but in Germany, where bank pools follow standardized contracts as pointed out by Brunner and Krahnen (2002). In Gilson, John and Lang (1991) and in Asquith, Gertner and Scharfstein (1991) it appears how the complexity of the capital structure, as measured in terms of private debt, debt owed to banks and the percentage of bank debt on total debt, may reduce the probability of success of a restructuring.

Villanova (2004) analysed the behaviour during restructurings of banks with senior exposures that progressively reduce their exposures, a feature consistent with Franks and Sussman (2003). Banks' intervention in a distressed company's equity is typically rare, given banks' lack of interest in directly managing a company, an activity far away from traditional banking activity. Nonetheless, there are still cases where banks decide to become shareholders' of a distressed company, typically through credits' compensation, so as to reduce debt burden, increase capital buffer and benefit from a potential up-side of company's performance.

The role of the banks in restructuring is also analysed by James (1995): fairly reasonable, banks' intervention is heavily linked to the financial state of the company and future perspectives, but also to the presence of public debt in the capital structure and to its complexity in terms of negotiability. Empirically, it also emerges that whenever banks take equity, they assume a substantial portion and hold it for more than two years on average.

In the perspective of keeping a company as a going concern, it is critical to investigate how the restructuring would impact on the asset side of the balance sheet, as investments are necessary in order to realise the company turnaround in the medium term.

Myers (1977) underlined the difficulty for distressed companies to issue new capital or debt for the purpose of new investments: for this reason, his research highlighted that restructured companies are typically undercapitalised also in the years following a turnaround. Whit regards to this, Aquith, Gertner and Scharfstein (1991) investigated the evolution of capital expenditures (capex). In their sample of distressed companies they find a significant reduction in capex, (about 83% of companies reduced it from the previous year to the year after the start of the crisis). In the same research, there is no evidence that companies with better performance in terms of operating margin and cash flows are more successful in the management of the crisis: their probability of going bust, of selling assets or of reducing capex is the same as that of companies with worse performances. Contextually, asset sales are typical in restructurings - see again Asquith, Gertner and Scharfstein (1991) and Gilson, John and Lan (1991) with regards to this - in order to focus on core business, free trapped liquidity and pay creditors.

## 3. THE PREVENTIVE ARRANGEMENT WITH CREDITORS-P.A.C. ("*CONCORDATO PREVENTIVO*").

In a few words, PAC is an arrangement with creditors that the debtor may propose filing at the Court where the company has its legal registered office. The procedure is similar to the US's Chapter 11, which was taken as model for the Italian regulatory reform of 2005. This had the purpose to allow companies' restructuring, preserving their value. The assessment of the factors that led to the financial collapse is a

necessary step for the debtor in order to be aware and interpret the symptoms, and to outline the restructuring strategy into a plan. In the PAC, the proposal extends along one of the following alternatives:

a) restructuring of debts and satisfaction of credits through any form, including the sale of assets and the allocation of shares or other financial instruments (the so called “liquidation agreement”);
b) business going on under managed by the debtor ("*continuità diretta*”) as introduced in the Italian Insolvency Law in 2012;
c) business or part of the business going on transferring the property of it to one or more different companies ("*continuità indiretta*”).

In the first case – liquidation agreement - the debtor must “ensure” payment of unsecured creditors and a minimum payment of at least 20% of the corresponding original unsecured debt.

The restructuring plan has to be revised by an Independent Expert (IE) – named “*Attestatore*” - who is called on the one side to audit the accuracy of the company’s data and on the other side to assure the feasibility of the plan. He is appointed by the debtor but he behave as a third party and does not qualify as a company consultant. Some Scholars consider the IE close to a “judge assistant” as his due diligence is aimed at guarantee the fairness of the prospected initiatives and the level disclosure to safeguard stakeholders, in particular creditors and the Court itself (Vitiello, 2013; 2014). His work consist in verifying the quality of the plan and in informing both the creditors and the Court about the situation of the analyzed company.

The Court examines the petition and, if it concludes that it is complete and compliant to the law, it admits the debtor to the PAC, appointing a Judge and a Judicial Commissioner (JC).

After an agreed period, the Judicial Commissioner presents his Opinion on the PAC to creditors in order that they can vote the proposal while fully informed. If the the majority of unsecured creditors approves the proposal, the court opens the last phase of the procedure which takes to the final judgement (“*omologa*”), after which the PAC can be executed.

In 2012 it was introduced the opportunity to gain an automatic stay period during which the law establishes protection against creditors (“*concordato in bianco*” ): companies can ask the Court to have from 60 to 180 days to prepare their restructuring plan and all the documents necessary to fill in a PAC (Danovi, 2014; Danovi and Quagli, 2015). The procedure was amended the following year with more strict requirements regarding the obligation for the debtor to deposit the balance sheets of the last three years, the possibility for the Court to issue periodic reporting requirements during the stand still period and the inadmissibility of further applications if one has already had accepted in the previous two years. This occurred as many insolvent entrepreneurs used this opportunity mainly to defer bankruptcy, instead of to face insolvency. (Lo Cascio, 2015; Vitiello, 2013).

The legislator intervened once more in 2015 by adopting measures aimed at introducing some more competitive market mechanisms in PACs procedures. On one hand, creditors that represent at least 10% of the outstanding credits can file competing proposals in the 30 days before the creditors’ meeting. On the other hand, if the PAC includes an offer by an entity for the transfer of specific assets, or the whole or part of the business as a going concern, the Court can seek other offers by opening a competitive market procedure. The reforms cleared out that the priority for the legislator and for the different actors playing their roles in crisis and turnaround situations must to safeguard and to better enhance company’s value and when possible to preserve going concern.

## 4. THE EMPIRICAL RESEARCH, METHODOLOGY AND HYPOTHESES

To our knowledge, this work is one of the first to map Preventive Arrangements with Creditors in Italy. We aim to provide practitioners of the discipline scientific and statistical background to practices currently in use in such insolvency procedure.

The analysis presents descriptive statistics for the sample in terms of characteristics of the companies that filed for the procedure, the different ways the process has been managed by companies, the role of the Court, of the advisors and of the independent auditors, the costs and results of the agreements.

The following hypotheses has been tested.

*H1: Preventive Arrangements with Creditors (PACs) are an effective tool to deal with distress.*

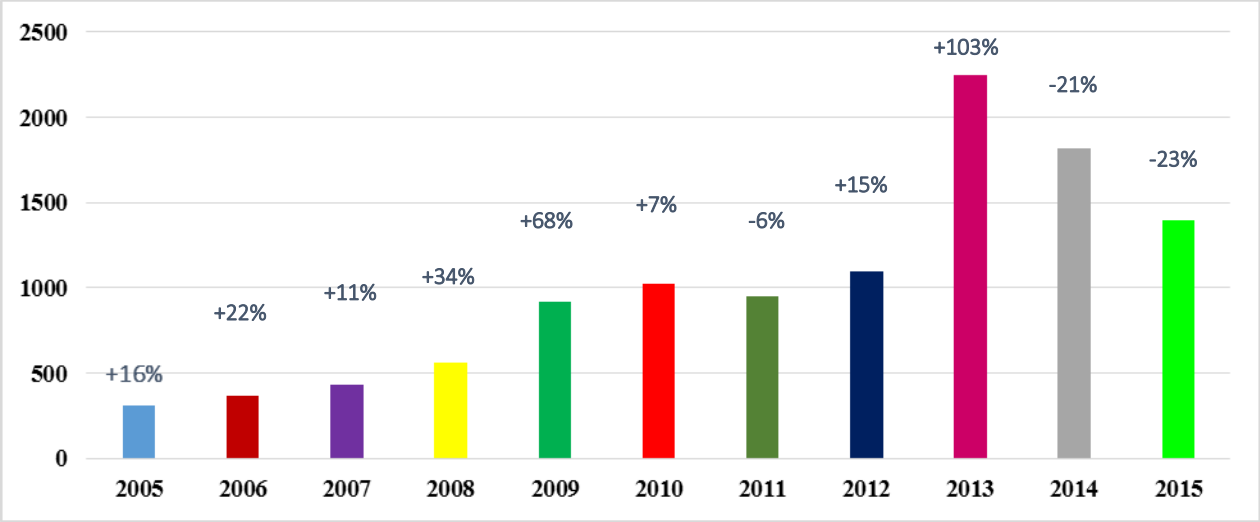
The sample consists of Preventive Arrangements with Creditors filed in the Court of Milan in Italy. Observations in our sample refer to years between 2005 and 2014 included, as Italian Insolvency Law has been widely reformed since 2005 in order to introduce new legal procedures aimed at preserving troubled companies. A total of 835 PACs, 70% of the total number, have been examined.

## 5. ITALIAN DATA AND THE COURT OF MILAN

The general economic crisis and recent regulatory revisions have encouraged a surge in the numbers of procedures in all Italian Courts. Since 2005, with the exception of 2011, the number of filing procedures has grown steadily. The phenomena was particularly important from 2012 to 2014 while relevant reductions was registered in 2014 and 2015. The largest number of stand still procedure was filed in 2013 (4,629) and about a third has actually turned into PACs. In 2014 pre-arrangements decreased by 37.2% (2,908) with consequent reduction of PACs (1,819, - 20% compared to 2013). Confirming the trend, also 2015 was down by 23.6% compared to 2014 and 38.4% compared to 2013 (Dell'Oste, Maglione and Nariello, 2015). Different law modifications can explained these figures.

As general Italian data show, the first introduction of the new rules caused a significant increase in the number of PACs filled in, especially in the first half of 2013 (87.5% more than the same period in 2012). Nonetheless, September 2013 regulatory reviews, including the possibility for the Court to appoint a Judicial Commissioner (JC) to monitor the debtor's conduct during the first stand still period, caused a decrease, which endured throughout 2014 and 2015. An interesting and opposite trend is registered as in 2014 while the number of PACs decreased, bankruptcies reached their record (over 15,700). On the contrary in 2015, for the first time since the worldwide crisis started, bankruptcies decreased (14,700 procedures, 6.3% less than the previous year), still maintaining high values compared to the historical average.

**FIG. 1: PACs submitted in Italy 2005-2015**




* Stand still procedures are excluded.
**Source: Author's elaboration from Cerved data.**

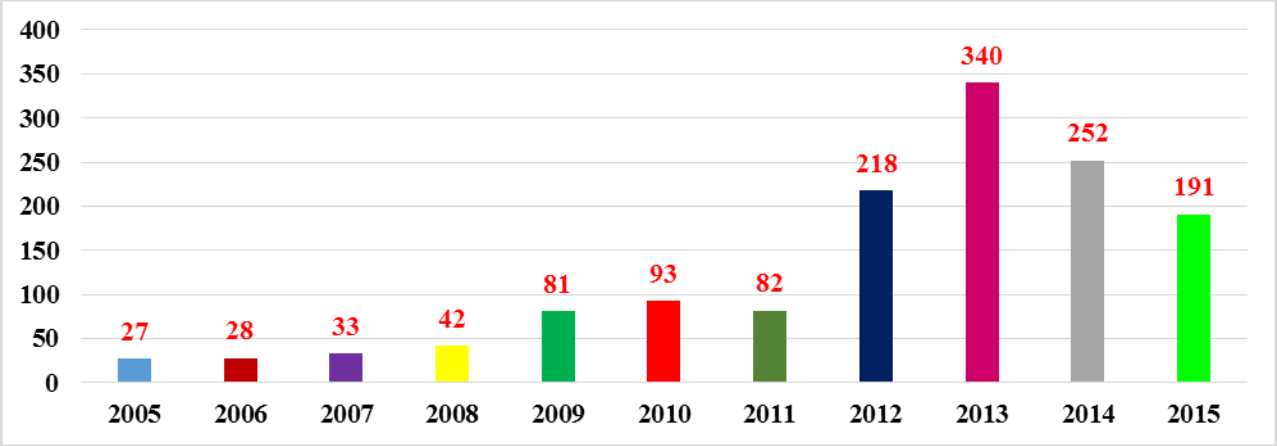
The Court of Milan, which has made available for the purposes of this research the access to all PAC's files, is within the main in Italy by number of filed insolvency procedures, which have been increasing since 2009. In the 2005-2007 period the annual number of PACs was around 30 units, while in the following years it tripled and grew up to eleven times as much in 2013. In 2009, in fact, there was a 48% increase (from 42 to 81 applications), while between 2010 and 2011 the number stabilized at around 80-90 requests.

In 2012 it would have been likely to reach similar numbers (72 applications as of September 2012), but the introduction of the Pre-arrangement generated a significant discontinuity, as 146 applications were filed in only three months. In 2013, the number grew up to 340 applications, while in 2014 and 2015 respectively 252 and 191 application PACs were filed in with a decrease of 26% and 24% over the previous year.

It is also worth mentioning that in 2012 out of 146 applications filled in since September, 134 - which represent 92% of the total number - were "stand still procedures" ("*concordati in bianco*") that is, as it will be explained further below, an applications presented by companies to get a safe period to prepare the plan.

The same relevant figure can be found in the following years: in 2013 stand still procedures were 328 that is 96% of the total figure; in 2014 they were 227, that is 90%; and finally, in 2015 they were 178 which is 93%.

**FIG. 2: Applications filed at the Court of Milan from 2005 until 2015**




**Source: Authors' elaboration**

## 6. DATA ON PACS AT THE COURT OF MILAN

Data reported in the previous paragraph show that in recent years PAC has assumed wide relevance as company restructuring instrument, reaching thereby one of the first regulator objectives. In the present paper, we investigate all applications filled in at the Milan Court to evaluate the effective use of the tool. The research, still in progress, collects information about: the characteristics of the companies that filled in the procedure, the different ways the process has been managed by companies, the role of the Court and of the advisors and of the independent auditors, the costs and results of the agreements.

Currently, the files of 835 companies that have applied for a PAC were examined (70% of the total of Milan Court procedures). Table 1) shows the number of filling in per year and the percentage of those analyzed with respect to the total in the same period. The partial availability of documents for some procedures did not permit a complete reconstruction of all the applications included in the database.

**TAB. 1: Number of examined PACs applications**

| YEAR | SAMPLE | TOTAL | % |
|---|---|---|---|
| 2005 | 5 | 27 | 19% |
| 2006 | 6 | 28 | 21% |
| 2007 | 8 | 33 | 24% |
| 2008 | 30 | 42 | 71% |
| 2009 | 63 | 81 | 78% |
| 2010 | 93 | 93 | 100% |
| 2011 | 82 | 82 | 100% |
| 2012 | 196 | 218 | 90% |
| 2013 | 238 | 340 | 70% |
| 2014 | 114 | 252 | 45% |
| **Total** | **835** | **1.196** | **70%** |

The sample includes 120 stand still applications in 2012, 232 in 2013 and 112 in 2014, but less than half of them were able to go on with the process accomplishing it with a full PAC after the period granted to prepare the plan.

We excluded from the analysis 255 procedures for which the plan was not completed and the full PAC filled in. This first result unfortunately confirms the national figures described above in the previous paragraph.

**TAB. 2: Stand still procedures in 2012 and 2013**

| | 2012 | | 2013 | | 2014 | |
|---|---|---|---|---|---|---|
| | N. | % | N. | % | N. | % |
| 1) application of the restructuring plan within the deadline | 55 | 46% | 101 | 44% | 53 | 47% |
| 2) non-application of the plan | 34 | 28% | 72 | 31% | 27 | 25% |
| 3) revocation filed by applicant or Court | 9 | 7% | 43 | 19% | 23 | 21% |
| 4) filing for bankruptcy on one's own | 11 | 9% | 13 | 6% | 2 | 2% |
| 5) declaration of lack of jurisdiction of the Court | 8 | 7% | 3 | 1% | 7 | 6% |
| 6) application of debt restructuring agreements under at. 182-*bi*s of IL | 3 | 3% | 0 | 0% | 0 | 0% |
| **Total** | **120** | **100%** | **232** | **100%** | **112** | **100%** |

The full applications were followed by admission to the PAC procedure in 84% of cases, after the Court assessed whether the necessary conditions were achieved (art. 163 IL). Among the reasons to refuse admission a few resulted recurring:

a) inadequacy or even wrong structure of the application or of the proposal to the creditors;
b) deficiencies in the Independent Expert's (IE) opinion attached to the full application;
c) improper creditors classification;
d) prevision of inadequate payments for creditors;
e) prevision of a partial satisfaction of secured creditors non-compliant with art. 160 of IL which asks for a special appraisal.

Then approved PACs are on average only 59% of the ones initially admitted by the Court. In 2010 and 2011 the average decreases. Among the causes of non-approval the following are the more relevant:

i) in 51% of the situations, the Judicial Commissioner recommended to revoke the admission (under art. 173 IL);
ii) in 32% of the cases, the majority of creditors did not approve the plan proposed;
iii) in a few PACs the applicant issued a waiver or the company was not able to deposit the amount of money requested by the Court to face procedure expenses.

**TAB. 3: Number of PACs admitted and number of PCs approved**

| YEAR | ADMITTED | % | NOT ADMITTED | % | APPROVED | % | NOT APPROVED | % |
|---|---|---|---|---|---|---|---|---|
| 2005 | 0 | 0% | 5 | 100 % | 5 | 100 % | 0 | 0% |
| 2006 | 0 | 0% | 6 | 100 % | 6 | 100 % | 0 | 0% |
| 2007 | 0 | 0% | 8 | 100 % | 8 | 100 % | 0 | 0% |
| 2008 | 0 | 0% | 30 | 100 % | 22 | 73% | 7 | 27% |
| 2009 | 0 | 0% | 63 | 100 % | 39 | 62% | 20 | 38% |
| 2010 | 22 | 24% | 71 | 76% | 33 | 46% | 38 | 54% |
| 2011 | 25 | 30% | 57 | 70% | 28 | 49% | 29 | 51% |
| 2012 | 21 | 16% | 110 | 84% | 66 | 60% | 42 | 40% |
| 2013 | 15 | 14% | 92 | 86% | 55 | 63% | 31 | 37% |
| 2014 | 7 | 13% | 48 | 87% | 29 | 60% | 19 | 40% |
| **Total** | **90** | **16%** | **490** | **84%** | **291** | **59%** | **186** | **38%** |

**TAB. 4: Classification of not approved agreements**

| YEAR | REVOCATION ART. 173 IL | % | NO MAJORITY | % | OTHER | % |
|---|---|---|---|---|---|---|
| 2005 | 0 | 0% | 0 | 0% | 0 | 0% |
| 2006 | 0 | 0% | 0 | 0% | 0 | 0% |
| 2007 | 0 | 0% | 0 | 0% | 0 | 0% |
| 2008 | 2 | 25% | 1 | 13% | 4 | 50% |
| 2009 | 7 | 29% | 13 | 54% | 0 | 0% |
| 2010 | 25 | 66% | 11 | 29% | 2 | 5% |
| 2011 | 13 | 45% | 14 | 48% | 2 | 7% |
| 2012 | 22 | 50% | 10 | 23% | 10 | 23% |
| 2013 | 16 | 45% | 6 | 18% | 9 | 27% |
| 2014 | 10 | 53% | 3 | 16% | 6 | 31% |
| **Totale** | **95** | **50%** | **58** | **32%** | **33** | **18%** |

To better describe the registered phenomena we first analyze the main characteristics of the companies asking for admission. Then we go over the main events in an historical perspective to check the corporate governance and ownership of the debtor; and last evaluate the characteristics of the sector (Gennari and Panizza, 2015).

The purpose is to outline the business environment in which the companies operated and may still pretend to operate. This will lead to a better understanding and outlining of the causes of the financial collapse and consequently to a better formulation of the strategies necessary for the recovery.

The sample is composed by private companies (72%) or public companies (23%). Sole proprietorships and partnerships are as expected less represented in the sample (4%). More than half of the companies show a concentrate ownership (one to four owners) and 14% of the sample is composed of private companies with a sole owner. This data confirms the important presence of family businesses, typical of the entrepreneurial Italian environment.

**TAB. 5: Companies' legal form**

| LEGAL FORM | N. | % |
|---|---|---|
| Sole proprietorship | 3 | 0% |
| Partnership | 30 | 4% |
| Limited partnership | 6 | 0% |
| Private company | 599 | 72% |
| Public company | 188 | 23% |
| Limited partnership by shares | 1 | 0% |
| *Not available* | 7 | 1% |
| **Total** | **720** | **100%** |

With reference to the size, adopting the definition of the European Commission, we divided the sample into four clusters based on the number of employees hired the year prior to the filing. As reported in Table 6), companies are mostly micro and small, that is, with a workforce of less than 50 employees. About one tenth of the sample is medium sized, while large companies are almost missing as they count altogether only 1%.

This happens probably because large companies can fill in for a different and *ad hoc* procedure, the Extraordinary Administration. The annual turnover confirmed the analysis as within the sample it resulted in 10 million euro on average (median € 2.7 million euro).

**TAB. 6: Companies' size**

| SIZE | N. | % |
|---|---|---|
| Micro (1-9 employees) | 313 | 37% |
| Small (10-49 employees) | 280 | 34% |
| Medium (50-249 employees) | 88 | 11% |
| Large (beyond 250 employees) | 9 | 1% |
| *Not available* | 145 | 17% |
| **Total** | **835** | **100%** |

The distribution of the sample among different sectors of activity leads to the conclusion that the crisis has hit the tertiary and service sectors more strongly (40%), followed by the manufacturing one (32%). Even real estate and constructions appear to have experienced a sharp decline. In the manufacturing sector, companies primarily hit by the crisis belonged to the metallurgy, paper and publishing, and electronics activities. Within the tertiary sector the highest rates were registered in trade, both wholesale and retail, followed by catering and tourism. Anyway, in general, although some sectors were more exposed than others, all of them were affected by the phenomenon. In fact, at least one company in each sector applied for PAC.

**TAB. 7: Sector distribution of sample companies**

| SECTOR | N° | % |
|---|---|---|
| Primary | 1 | 0% |
| Manufacturing | 267 | 32% |
| Tertiary | 335 | 40% |
| Real estate and constructions | 166 | 20% |
| **Total** | **835** | **100%** |

## 7. MAIN EMPIRICAL EVIDENCE ON PACS

All plans submitted by the 580 companies of the sample, which fulfilled the PAC procedure, were examined through a cover-to-cover reading of all the documents found in the Court's files. More specifically, for all the filled in procedures, it was carried out an analysis of: i) the application filed by the company; ii) the opinion on the plan ("*Attestazione"*) drafted by the Independent Auditor; iii) the Judicial Commissioner report pursuant to art. 172 IL or art.173 IL; and finally iv) the Judicial Commissioner opinion pursuant to art. 180 IL. To further support the analysis, we processed the Court's decrees of admission (or non admission) and of approval (or non approval). The following pages summarize the results, paying particular attention to the main characteristics of the restructuring plans and to the intervention of the Judicial Commissioner during the procedure.

The analysis starts considering the causes of the crisis as represented within the Court's files. As most of scholars stated, from an economic perspective, corporate crisis is an evolutionary process that leads to the destruction of corporate value (Danovi, 2014). Crisis is not, therefore, a sudden event, but it is characterized by a series of concurrent phenomena, say a cluster of causes, which contribute to worsen the situation leading to the precipitating cause (trigger event). Models identified by literature suggest a clear distinction between factors that are exogenous or external to the company and factors that are endogenous or internal to the company. Following this classification, the research consider on one side exogenous those causes arising from macro-economic phenomena (general economic trends, changes in interest rates, exchange rates and prices of production factors, changes in legislation and environmental or socio-demographic changes) rather than from sectorial instability (variation of density, saturated demand, competitive tensions and technological innovations). On the other side, endogenous causes were classified by considering the following factors:

i) *strategic*, related to errors in drawing business plans and in management of the company;

ii) operational, related to problems encountered in the process of purchase-production-sale and related financial transactions;

iii) *corporate*, related to inadequate corporate governance and to operations of moral hazard in conflict with the company's objectives;

iv) *extraordinary*, with unforeseen events (death or disease of the entrepreneur, fire, theft or ineffective extraordinary transactions).

The picture outlined from the reading of companies application, Advisors reports, Independent Expert opinions, as well as Judicial Commissioner evaluations make it clear that the crisis of companies depended equally on both business and macro-economic factors, as well as on a mix of internal and external factors. In particular, the crisis of 2008 was often mentioned as the main cause of discontinuity determining a rupture in business going concern. Companies that fill in for a PAC should find themselves in a situation of financial difficulty, but they should not be in a condition of irreversible insolvency or in a situation where the risk of discontinuity is outlined. Italian legislator imagined PAC as an instrument to solve the crisis having mainly an anticipatory nature. On the contrary, the survey confirms that PACs are often used when the crisis has already disclosed its effects. It is enlightened that Italians entrepreneurs apply for the procedure late when the crisis has already shown its most serious consequences, thus delaying the positive effects of the restructuring procedure.

The choice of the best restructuring strategy actually first relate to the comparison between the liquidation value and the going concern value (Danovi, 2014). The liquidation choice is the most appropriate when the company's going concern value is under the liquidation value; conversely, the alternative of continuity is convenient when there is still a chance to recover and to create new value after the turnaround.

It is interesting to note that, as exposed below in table 8), liquidation occurs in more than half of the analyzed cases, precisely in 54% of the situations considered over time. The remaining can be qualified as agreements with the intervention of a third part (2%) or going concern agreements (34%). It is necessary in this regard to distinguish between (Riva, Bavagnoli, De Tilla and Ferraro, 2011):

- *direct managing of going concern* – in 9% of cases – which implicates that the firm continues to be carried on by the original entrepreneur from both an economic as well as a legal point of view;

- *indirect managing of going concern* – in 27% of cases – which implicates that the business goes on, but is transferred to another company. In this case (often before filing), the business is rented by a third party and later it is sold. Normally the acquisition takes place after the approval of the PAC. This setting out resulted in 70% of the applications with the indirect model. The immediate business sale was planned instead in the remaining cases, which reach 28%. Data confirm what scholars have been stating since the first years of application of the new law: business rent is a useful tool to preserve company's value, especially the intangible assets (Riva, 2011). The indirect strategy is appreciated because on one side it permits speed and flexibility in the executing the PAC and on the other side it is easier to implement (Panzani, 1998; Gitto, 2002).

The analysis points out that PAC appears to be a tool used both as a turnaround procedure and as well as a liquidation procedure (Danovi, 2014). Although there is a clear prevalence of the last use, the attempt in 205 cases to propose a plan that allows the recovery of corporate value needs to be highlighted.

**TAB. 8: Types of PACs plans (No available data on "type of plan" for 61 procedures)**

| YEAR | LIQUID. | % | CONTINUITY | | | |
|---|---|---|---|---|---|---|
| | | | DIRECT | % | INDIRECT | % |
| 2005 | 1 | 20% | 0 | 0% | 3 | 60% |
| 2006 | 2 | 33% | 0 | 0% | 1 | 17% |
| 2007 | 4 | 50% | 0 | 0% | 4 | 50% |
| 2008 | 21 | 70% | 1 | 3% | 8 | 27% |
| 2009 | 44 | 70% | 1 | 2% | 18 | 29% |
| 2010 | 49 | 53% | 7 | 8% | 34 | 37% |
| 2011 | 47 | 57% | 7 | 9% | 28 | 34% |
| 2012 | 76 | 58% | 12 | 9% | 43 | 33% |
| 2013 | 35 | 33% | 13 | 12% | 10 | 9% |
| 2014 | 35 | 64% | 10 | 18% | 5 | 9% |
| **Total** | **314** | **54%** | **51** | **9%** | **154** | **27%** |

The assets and liabilities in PACs are summarized in table 9). There is a high value of tangible assets, trade receivables and inventories. Few are the cases with financial contribution by shareholders or third parties (16% of the sample). As expected, liabilities are always higher than the real value of assets and consist mostly of unsecured debts. In general, banks are the most recurrent creditors. This is in line with literature, which suggests the use of a PAC when debts towards banks are relevant (Ranalli, 2015). Among secured creditors it turns out to be relevant the position of tax authorities together with social security institutions and employees, while suppliers mainly resulted among unsecured creditors. Deferred creditors are the 11% of cases. Finally it should be noted that pre-deductible debts including first of all the procedure costs (Judicial Commissioner, eventual appraisals and all other procedure expenses), the Independent Expert's opinion costs and the possible negative margin generated from the business continuity after the application, represent an average rate of 9% on the total amount of liabilities.

The analysis shows interesting results about the percentages that are disclaimed as payable to creditors as reported in the documents deposited in Court's files. It is worth to emphasize that the analysis does not consider the results obtained effectively in the execution phase, as it refer to what results from all documents produced up to the PAC approval ("*omologa*"). This considered, it emerges that:

- on one hand, almost all the sample companies - 90% - offer the complete satisfaction of secured creditors the others grant partial satisfaction of a further secured class of creditors, with an average rate of satisfaction of 51% (median 40%);
- on the other hand, to unsecured creditors is offered a percentage of satisfaction of on average 28%.

This finding is relevant because it helps reasoning about the sustainability of the thresholds introduced by the legislator in 2015. The distribution of the companies in the sample suggests that 50% of the analyzed procedures would not have had the chance even to be submitted. This may be asserted when considering not the average value of the results obtained, but the value assumed by the median of the distribution, which stood precisely on 20%. Actually, 20% the new law assets 20% as the minimum satisfaction value, which can be offered to creditors. Out of the 580 cases considered so far, 256 would have not fulfilled the parameters necessary to get their admission, with the exception of situations where third-parties intervention could have enhanced the opportunity to get external financial contribution.

It should be highlighted that 116 procedures are structured proposing a division into more categories of unsecured creditors and that, consequently, the average satisfaction rate decreases to 20% with a median of 11%. It is again important to specify that the debtor is responsible for the choice of the criteria that identify the creditors' categories, while the Court verifies the fairness of used criteria under art. 163 IL. Creditors categories need to be designed to ensure consistent behaviors towards subjects with

homogeneous characteristics. The prevision of unsecured creditors categories is considered a useful tool to incentivize the approval of the PAC agreement by creditors (Santoni, 2007).

**TAB. 9: Realizable assets and amount of debts as indicated in the restructuring plan (thousands of euro)**

| **A. ASSETS** | **Average** | **%** | **Median** |
|---|---|---|---|
| – Tangible Fixed Assets | 1,887 | 32% | 127 |
| – Intangible Fixed Assets | 234 | 4% | 0 |
| – Financial Fixed Assets | 741 | 13% | 0 |
| – Inventories | 925 | 15% | 37 |
| – Cash and Equivalents | 325 | 6% | 59 |
| – Trade Receivables | 1,489 | 26% | 424 |
| – Financial Current Assets | 165 | 4% | 0 |
| **Total assets** | **5,766** | **100%** | **-** |
| *Cash from sale of the Business as a whole or of branches* | *2,592* | - | 0 |
| | | | |
| **B. LIABILITIES** | **Average** | **%** | **Median** |
| **1) Predeductable** | **1,055** | - | **231** |
| – Secured: banks | 1,334 | 36% | 0 |
| – Secured: suppliers | 345 | 9% | 47 |
| – Secured: professionals | 130 | 4% | 4 |
| – Secured: employees | 791 | 22% | 173 |
| – Secured: Treasury and protection institutions | 1,039 | 29% | 231 |
| **2) Total secured creditors** | **3,639** | **100%** | **-** |
| – Unsecured: banks | 3,586 | 55% | 1,274 |
| – Unsecured: suppliers | 2,949 | 45% | 1,333 |
| **3) Total unsecured creditors** | **6,535** | **100%** | **-** |
| **Total liabilities** | **11,229** | **-** | **-** |

Finally, the research highlights relevant aspects in terms of duration and execution approaches as presented in the PAC plan. A restructuring plan must be developed and closed within a defined period of time pointing out the relevant milestones, that are the different activities and planned operations and their timing, explicating the starting and the expiring dates and indicating priorities. The plan has also to provide a monthly budget at least for the first year and the annual development of the plan for the subsequent years in terms of revenues and expenditures (Gennari and Panizza, in Fabiani and Guiotto, 2015 pp. 61-62). The analysis indicates that the execution of the plans is expected to take on average:

a) 18 months for the satisfaction of secured creditors (median 12 months);
b) 26 months for the settlement of unsecured creditors (median 24 months), with an estimated 29 months for the full execution (median 24 months).

Only 46% of the analyzed cases a structured action plan, consistent with the model proposed by the standards and the doctrine is presented. It is a significant result that allows rooms for improvement as a detail of the restructuring execution timing would allow conferring credibility to the plan. It seems that the more details are provided concerning the execution of the PAC agreement, the more the debtor's will to go through a realistic and workable plan will be perceived.

The Independent Expert checks the accuracy of data through inspections and by analyzing the company's documents in accordance with standards. To get this goal it is important a strict interaction with all corporate governance bodies, with the entrepreneur and the management, and in larger

companies with all supervisory bodies and finally with the experts appointed to appraise special assets. Exchange of information with all company's control bodies, in particular, can be useful to better plan auditing activities saving precious time (Riva and Provasi, 2013). The assessments expressed by the IE of course can't avoid being – as indeed every audit and assurance opinion - probabilistic, analyzing the accuracy of data through the use of sampling techniques, and subjective, being referred to estimates and assumptions formulated to evaluate the business.

The Judicial Commissioner (or panel of different Judicial Commissioners, as in 7% of the analyzed cases) is appointed by the Court first and foremost for the protection of creditors. Among the attributed tasks there is the drafting of a report on the sustainability of the PAC as proposed by the company to be drafted and transmitted at least 45 days prior to the creditors' meeting (Michelotti, 2015).

Data show that in 65% of cases the Commissioner give a positive and clean opinion (pursuant to art. 172 IL). In 14% of the examined cases, the opinion expressed in the report is positive but with exceptions as it includes references to critical situation that could lead to deviations from the straight execution of the plan, for instance it can refer about special risks considered worth of mention. Finally, in 21% of cases the Judicial Commissioner expresses a negative opinion and releases a report in which he requests the Court to revoke the admission to the PAC procedure (pursuant to art. 173 IL).

**TAB. 10: The Judicial Commissioner's report**

| **TYPE OF REPORT** | **N°** | **%** |
|---|---|---|
| "*Clean*" opinion 172 IL | 287 | 65% |
| Opinion with exceptions | 60 | 14% |
| Negative opinion 173 IL | 92 | 21% |
| No opinion released | 1 | 0% |
| **Total** | **440** | **100%** |

The analysis suggests the existence of a correlation, already enlightened by some scholars (Fabiani and Guiotto, 2015), between tight controls and detailed and effective disclosure carried out by the Independent Auditor during the earlier steps of the procedure and the probability of a positive opinion by the Judicial Commissioner in the following months of the procedure. In his report the Commissioner in fact analyses the IE report to evaluate the accuracy of the data and the feasibility of the plan.

When a substantial correspondence is found between what directly observed and what reported by the IE, the Commissioner can choose to base his own analysis on the one already conducted and accurately disclosed in the audit report. When this is the case, the Commissioner can plan only some selected procedures of detail or he can simply reduce the sampling levels in all procedures set up.

Furthermore, it is significant to note that in only in 79% of cases the Commissioner provides information on the suitability of alternative hypotheses to the PAC agreement, which usually is bankruptcy. This result is quite surprising as the comparison is considered relevant by Courts and scholars for creditors to express their opinion. In 61% of filed reports PAC arrangement is explicitly recognized as more effective than bankruptcy by ensuring a higher satisfaction of creditors.

In the remaining cases the Commissioner highlights the feasibility of the plan as well as the higher effectiveness of bankruptcy. In these special situations as the PAC agreement is considered consistent even if less convenient it is indeed left to creditors the decision to accept the restructuring plan or to refuse it getting, in accordance to the analysis of the Commissioner, a better monetary result with bankruptcy.

The survey has drawn attention to the following main disadvantages related to bankruptcy when compared with PACs: i) the loss of extra-guarantees ; ii) the failure to realize the company's assets at fair values; iii) the massive layoff of workers.

**TAB. 11: PAC and bankruptcy in the report ex art. 172 IL**

| | N° | % |
|---|---|---|
| Disadvantages of bankruptcy | 213 | 61% |
| Advantages of bankruptcy | 64 | 18% |
| The Commissioner does not express an opinion | 70 | 21% |
| **Total** | **347** | **100%** |

The survey covered also all reports composed under art. 173 IL, released in 21% of the situations and leading to the direct request to revoke the admission of the PAC agreement. In it the Commissioner is called, among other things, to describe his findings concerning criminal behaviors in the formulation of the PAC or debtor's illegal conduct registered during the period of application.

The Commissioner must highlight: the eventual assets concealments or dissimulations, the assessment of intentional omission of existing claims, the exposure of non-existent liabilities, and, finally, the recognition of other frauds. Out of the 92 total situation analyzed main findings regarded cover-ups of assets - 36% of cases - and the existence of acts of fraud - 19% of cases -. while in more than 25% of cases multiple investigations and consequently a number of different situations is described. The assessments made by the Judicial Commissioner are not binding and of course the Court who will provide for an independent exam of the situation, but the reports is seriously considered and usually plays a big role.

In the event of a positive vote by the majority of creditors, the agreement is finally approved, but the Judicial Commissioner is again called upon to draft a second final opinion (under art. 180 IL). Results were reassuring as in this last phase of the PAC path with few exceptions - 2% of contrary opinions in total – the Commissioner resulted approving.

## 8. CONCLUSIONS

The empirical analysis of Milan Courts evidence allows drafting some first conclusions on the use of PACS in the Italian system.

Collected data show that PACs have been widely used, from the 2005 IL reform to 2015. The intent of the legislator to use PACs to ensure company continuity and restructuring, does not seem to have taken on the role advocated as most of PACs end with the company liquidation. Over the years, there has been either a substantial presence of liquidation agreements, or a significant number of application with no further filing of a plan, thus not approved.

Most of procedures from 2012 file with the pre-arrangement scheme, but less than half present a complete plan. Thanks to the introduction of the pre-arrangements in 2012, the instrument has become very attractive for companies in crisis, even if often they are not able to start a real restructuring process. However the results are quite interesting: more than 85% of PACs presented are admitted and near 2/3 are approved by the Courts.

Due largely to the newness of the legislation, along with the complexity of the Italian system, it is rather difficult to generalize conclusions. Nevertheless, the paper shows how Preventive Arrangements with Creditors can be considered a more efficient instrument than the alternative bankruptcy, both in terms of timeframe as well as with creditors' satisfaction.

As part of the overall European reform process of insolvency proceedings, following the 2014 Recommendation issued by the European Commission, Italy seems to provide useful insights for other countries in Europe.

From a statistical point of view, the research is only descriptive and the sample can partially be considered representative of the whole Country. Obviously future researches will be able to more deeply investigate causal relationship through the different characteristics of companies and restructuring plans and the success of the recovery.

However, due to the newness of the phenome and lack of previous empirical research on the topic, we hope that data can be interesting for both scholars and practitioners.

**ACKNOWLEDGEMENTS:**

**Authors thank the Court of Milan and particularly the presidents Mr. Lamanna and Mrs. Paluchowski, as well as the judge Mr. Fontana for their support.**

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International Journal of Business Research™
Volume 16, Number 2, 2016

International Academy of Business and Economics®
IABE.org

IJBR ISSN: 1556-1296

9 771555 129089

Printed in the USA