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Technology Companies in Judicial Reorganization

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Abstract. The updating of the judicial reorganization and bankruptcy legislation, law 11.101/2005, resulted in an increase 63.7% per year of judicial recovery from 2005 to 2018, but with a success rate of only 1%. The speed of launching new technologies tends to contribute to the crisis in companies, and to emerge from this crisis, companies must be aware of the financial indicators and, when necessary, request for judicial recovery at the same speed of technological changes.

Keywords: recovery, revenue.

1 Introduction

The legal order of recovery and bankruptcy of the company in difficulty are instruments by which the entrepreneur manages to overcome the situation of crisis in the execution of the economic activity, in order to promote the preservation of their company, or to carry out the regular closing of the company, assuring the social function of this economic activity. [1]

The course of prescription when decreed a judicial recovery is 180 days, in this period, all executions of the company are suspended. Within this period, in the first 60 days, the company must present the recovery plan, which will be analyzed by the creditors and at the end of the 180 days at the general meeting of the creditors, they may approve the plan giving continuity to the company's activities, or refuse the plan, decreeing the bankruptcy of the company. In case of approval, the company continues in follow-up for 24 months, where it cannot request a new request for judicial recovery.

Even though it is a law of 2005, judicial reorganization (or recovery) has been gaining space as a survival option for companies by economic context, such as the changes in the external market due to the deceleration in China, or the reduction of the public deficit in Europe and in the peripheral countries, which caused difficulties in the verification of the value of the goods [2]. One of the sources of instability for companies in recent years, which possibly will extend for years, is the high rate of breakthrough innovation, due to the emergence of new products and services based on innovative technology. This is what happened with the emergence of music streaming, according to the annual Pro-Music Brazil report this kind of services such as digital media and streaming like Spotify, Apple Music and YouTube had revenues of \$ 178.6 million in Brazil in 2017, compared to \$ 15.8 million millions of physics like CD and

DVD [3]. Another platform, Airbnb, according to research by the Foundation for Economic Research (Fipe), showed that Airbnb added R \$ 2.5 billion to the Brazilian GDP in 2016, even though it still represented only 2.1% of the total number of guests in Brazil [4].

Since the creation of this law, there has been an exponential increase in the request for judicial recovery, from 110 in 2005 to 1863 in 2016. The recoveries granted went from 1 in 2005 to 606 in 2018. However, the recovery rate of US companies is 30% and Brazilian recovery is 1%.

Therefore, this paper aims to identify the causes of the inefficiency of the Brazilian process, firstly, comparing the Brazilian and American legislation, and then, financial indicators of Brazilian companies that can indicate the index of success of the judicial recovery in Brazil.

2 Methods

As judicial reorganization is a legal process, the vast majority of published studies and books are prepared by a lawyer and addressing only the legal aspect. So initially, we will address the legal issue and make a comparison between Brazilian and American legislation (which inspired the Brazilian legislation) to identify whether there is any aspect in Brazilian law that could imply an increase in corporate mortality in judicial reorganization proceedings [1][13].

Then, we will address the financial aspect of companies in judicial recovery as a way to understand the economic situation [7] of a company is to evaluate the financial indicators [12]. In accordance with determinations by the Brazilian Securities and Exchange Commission (law 6.404/1976) and law 11.101/2005, corporations are required to disclose financial information such as balance sheet, statement of accumulated profits or losses, statement of income for the year and demonstration of the origins and applications of resources. So, we examined the financial statements of the companies and analyze the economic indicators of technology companies in the interior of São Paulo. The choice of this region is due to why companies have similar and competing products, and with the advent of new technology, their products have become obsolete, and mainly because we have access to data.

3 Results

The mortality index is too high of companies that has judicial recovery accepted. So, this article will take a look on legislation and studied cases of three similar companies in judicial recovery and their financial statements.

3.1 Legislation

This article will outline an overview of the American Law and the Brazilian Law, studying the peculiarities of each one, regarding the recovery of companies, pointing

out some of the differences, similarities and contrasts between the laws of the two countries.

Table 1, comparison of Law 11.101 with the American chapter 11, does not intend to compare perfect equivalents, as we know, they are two countries of different formations and peculiarities, and especially under quite different legal orders.

Table 1. Comparative – Brazilian vs American Legislation [2]

| Topic | Brazil | US |
|---|--|--|
| Companies emerging from judicial recovery | 1% | 30% |
| Deadline for plan submission | 60 days | 120 days, with possibility of extension for up to 18 months |
| Classes of creditors | Labor creditors, secured and unsecured creditors. | Free to create class of creditors. It allows greater freedom of negotiation. |
| Business excluded from judicial recovery | Banks, financial institutions, health plans and insurance companies. | Operators of railways, stock brokers and commodities. |
| Who can request recovery | Business only. | In addition to companies, individuals and even counties. |
| Bankruptcy administrator function | Acts as a debtor's taxpayer. | The bankruptcy administrator also performs administrative duties. |
| Role of the treasury | Does not participate with its financing credits of the company's recovery. | Tax authorities can make concessions and receive shares. |
| Maintenance of the lender in the administration | Yes, unless there is fraud. | Yes, under the possession debtors figure, unless there is fraud. |
| Block sale | When there is bankruptcy. | Block sales can be made. |
| Voting of the recovery plan | Majority of votes is needed and, for the application of cram down, approval of at least 1/3 of the dissenting class. | The court has greater freedom to apply the cram down. |

The Brazilian legislation was based on Chapter 11 of the US Code: Bankruptcy, so similar results would be expected, but we can verify that the results are other. The

American success rate, historically, varies between 20% and 30%, well above the Brazilian 1% [6].

The legislation has no influence on the outcome of the judicial recovery, so we will analyze the companies economic indicators to try to understand the differences between Brazilian and American companies.

3.2 Studies Cases

The cases analyzed belong to three companies that have applied for judicial reorganization, following the arrival of an innovative product that competes head-on with products already consolidated in the market offered by the analyzed companies.

The lamps intended for residential lighting were the incandescent type, which consumed a lot of energy and lasted a short time and were gradually replaced by compact fluorescents, or electronic lamps, four times more efficient and six times more durable than incandescents, with greater environmental impact. Recently, the popularization of LED light bulbs - Light Emitting Diodes, which offer low power consumption, longer life span and lower environmental impact - has emerged as a competitor to incandescent bulb companies and lamp reactors [5].

The analyzed companies did not see the change and continued to produce luminaires and reactors for the fluorescent lamp segment. It was not long before the revenue started to decline and when they tried to produce this new technology and put their products on the market, they came across a relentless player, China, with an extremely cheap and lowcost product, making local manufacturing impractical. These companies have produced more than 70,000 reactors per month; today, production does not reach 8,000 reactors per month. This reduction shows the progress of the LED, and the cycle of fluorescent lighting is coming to an end, production today is only for the maintenance of luminaires installed before the arrival of the new technology.

3.2.1 Economic Indicator

Economic and financial indicators are the basis of key indicators of a company and used to elaborate strategic planning [11]. They are performance measurement thermometers and evaluation of the operational process of business organizations.

In accordance with Brazilian law 6.404/1976, corporations are required to disclose financial information. So, we choose and analyze three indicators to understand the economic situation of three technology companies in the interior of São Paulo that were based on the manufacture of products for fluorescent lighting and their financial results in the last 3 years before the judicial recovery. These data are public and they are in the initial petition of the companies. Companies will be defined as company A,

company B and company C. Company C filed for judicial recovery in 2015, while companies A and B applied in 2016.

3.2.2 Revenue

The revenue corresponds to the sum of sales of products and / or services in a given period. It is all the incoming money that goes into the company's cash, from the products sale, merchandise and services.

Table 2. Annual Revenue

| Revenue | 2013 | 2014 | 2015 | 2016 |
|-----------|---------------|----------------|----------------|---------------|
| Company A | - | R\$72.475.814 | R\$66.802.036 | R\$59.650.522 |
| Company B | - | R\$120.837.892 | R\$104.249.675 | R\$70.336.793 |
| Company C | R\$40.155.741 | R\$47.020.971 | R\$26.518.663 | - |

The companies already showed a drop in revenue with the arrival of LED, company C, realizing this, requested for judicial recovery, and stopped with the production of fluorescent technology after accepting the order in 2015, this resulted in a significant drop in sales, but made it possible to return production to other products more suited to the needs of the market.

3.2.3 Financial expenses

The financial expense represents the price to be paid by an enterprise to its creditors, and are related to interest from loans contracted by the business, in two companies the values are significant.

Fig. 1. Financial expenses

| | 2013 | 2014 | 2015 | 2016 |
|-----------|---------------|---------------|----------------|---------------|
| Company A | - | -R\$192.818 | -R\$333.307 | -R\$3.465.011 |
| Company B | - | -R\$7.153.784 | -R\$14.183.558 | -R\$7.504.673 |
| Company C | -R\$2.105.709 | -R\$6.163.756 | -R\$1.049.138 | - |

Brazilian interest rates in 2018, considering Brazilian real interest rates of 4% per month (excluding inflation in the next 12 months), among the 40 countries analyzed, Brazil occupies the fourth position, behind Turkey (13.93%), Argentina (18.20%) and Russia (6.01%) [10]. The costs of these companies for using third-party capital are very high, making them even less competitive in the market.

Company C reduced financial expenses in 2015 with the request for judicial recovery, thus, the cash flow of this expense, can be used for other purposes.

3.2.4 Statement of Profit or Loss

Profit or loss is the amount that results from a commercial transaction, when we take into account the amount received minus the costs of production. In other words, it is the amount that remains in each business transaction when we discount all the direct and indirect costs that a product has.

Table. 1. Statement of Profit or Loss

| Profit/Loss | 2013 | 2014 | 2015 | 2016 |
|-------------|---------------|---------------|----------------|----------------|
| Company A | - | R\$223.904 | R\$76.985 | -R\$4.873.362 |
| Company B | - | R\$173.903 | -R\$17.794.254 | -R\$13.352.732 |
| Company C | -R\$3.781.724 | -R\$8.132.169 | -R\$745.640 | - |

Company C reduced the damage to amounts consistent with the revenue, while company B and C, significantly increased the loss and still maintained the production of an outdated technology. Today, company C has left the judicial recovery and is fulfilling the commitments made to the creditors' meeting. Company A and B are in serious financial difficulties because of the late request for judicial recovery.

4 Conclusion

The modernization of Brazilian law did not work to improve the success of requests for judicial reorganization today by 1%, comparing the results of the American law that served as a basis and today has a success of 30%.

Taking too long to admit that the financial problem is serious is the most common mistake of entrepreneurs on the brink of crisis. (Bertão, Naiara, 2018). When analyzing the financial data of companies A, B and C, it is clear that company C, which requested the judicial recovery in advance, was able to reorganize and get out of the crisis, is now with the plan approved and fulfilling the agreement of the creditors meeting. The company A and B, with the late request, are in serious economic difficulties and with many debts regarding the approval of the economic plan by the assembly of creditors. An early request could allow the survival of these companies, as they would still have revenues in line with financial expenses, which would allow a change of course (development of new technologies) with a greater prospect of success.

Companies, especially in the technology sector, have to be very attentive to the changes of technology and innovations, only then, can survive in the world today, where revolution 4.0 is already a reality.

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