CORPORATE VOLUNTARY ARRANGEMENT: A LITERATURE REVIEW

Julizaerma Mohamad Khudzairi, Universiti Teknologi MARA
Norziana Lokman, Universiti Teknologi MARA
Sarina Othman, Universiti Teknologi MARA

ABSTRACT

A corporate voluntary arrangement (CVA) is a debtor-in-possession approach to rescue financially distressed companies. The introduction of a CVA into the corporate rescue mechanism of the Malaysian Companies Act 2016 appears to be a strategic option for a viable private company facing financial distress to have better debt negotiation for long term economic sustainability. This research reviews prior studies on the corporate rescue mechanism with specific reference to the CVA in Malaysia. A traditional desk-based research method was employed to review and evaluate existing investigations related to CVAs, and the appropriate comparison of advantages and limitations, similarities and differences of CVAs in Malaysia and in the UK were made. This study also offers suggestions for improvement in the CVA process and highlights areas for future research.

Keywords: Corporate Voluntary Arrangement, Corporate Rescue Mechanism, Online Procedure, Financial Distress, Companies Act 2016.

INTRODUCTION

The year 2020 started with an unexpected global situation. The spread of COVID-19 has been affecting economic conditions worldwide. The cross-border restriction, lockdown and movement control order resulted in the suspension of company operations that altered supply chains. The increase in non-performing loans and strict provision of credit because of market disruption will result in more companies closing their businesses worldwide. The insolvency situation will influence small businesses. In Malaysia, the Deputy Minister of Domestic, Trade and Consumer Affairs reported in Dewan Rakyat that over 4,000 companies in Malaysia have been liquidated since April 2020 (Kaur, 2021). The government intervened to help small and medium enterprises (SMEs) and individuals by introducing the Economic Stimulus Package 2020. Some countries such as Australia and Singapore introduced COVID-19 special laws to assist financially distressed companies. Legislative reform will be beneficial in helping a viable company that faces financial difficulties to continue its operation. In Malaysia, the CVA is one of the corporate rescue mechanisms in the Companies Act 2016 and is introduced as a tactical approach to assist viable companies in managing their debt and continuing their operations.

Motivation and Corporate Voluntary Arrangement Studies

In general, the CVA is under-used and has a record of relatively high failure rates especially in the UK (Walters and Frisby, 2011; Walton et al., 2020). Toys R' Us is one of the companies that entered into CVAs under the UK administration procedure in 2017. A company applies for a CVA because it is unable to fulfil its debt obligation and secure investors. A CVA is considered to fail when it is terminated without full implementation or when the company is unable to remain in the industry after CVA implementation (Walton et al., 2018). This result is consistent with the analysis made by the PricewaterhouseCoopers which indicates that more than half of CVAs have failed (Hussain et al., n.d.). The company must enter into another insolvency procedure because of the increment in liability. CVA failure will also lead to an adverse effect on investment value. Another reason for CVA failure is because the management wants to retain its power to lead the company (Hancock and Gross, 2020). Given the underutilisation of the CVA and its possible high failure rate, exploring and revealing the limitations and challenges that contribute to unsuccessful CVA implementation in the context of Malaysia is critical.

The CVA process appears to be fast and straightforward relative to other formal rescue mechanisms. However, CVA implementation is challenging as stakeholder agreement is required to proceed with the CVA plan. Gould (2010) admitted that obtaining creditor approval for the CVA proposal is problematic. This situation arises because creditors have the negative perception that a proposal favours the debtor company. Therefore, Gould (2010) suggested that obtaining the assent of creditors at the early stage of proposal drafting is vital if the CVA is to attract support amongst creditors. Furthermore, the proposal should appear appealing to creditors and seem fair to those affected, namely, creditors, shareholders and other unsecured creditors. Thus, investigating the limitations and challenges of CVAs is crucial to ensure that that CVA proposal will receive favourable support from the majority of creditors.

A few investigations have concentrated on several aspects of the CVA, including its successful and limitation (Cook et al., 2001; Cook et al., 2011; Fu and Tomasic, 2017; Pandit et al., 2000; Walters and Frisby, 2011; Walton et al., 2020) as well as legal implications (Kastrinou, 2016; Parkinson, 2016; Yeowart, 2009). Similarly, CVA studies in Malaysia mostly involve conceptual and legal concerns (Chen et al., 2020; Dahlan and Masurn, 1985; Lokman et al., 2020) as CVAs have been introduced for less than three years. A study addressing the solution for CVA limitations or procedural improvement is indeed significant to ensure that the CVA is sufficiently reliable for adoption by Malaysian companies with financial difficulties.

This paper begins with an introduction to the CVAs in the UK and Malaysia through a thorough review of the literature on the similarities and differences of their respective CVAs, followed by the advantages and limitations of CVAs. The resulting discussion, conclusion and suggestions for future research are also provided at the end of the section.

Corporate Voluntary Arrangement in the UK

The CVA was introduced from the Cork Committee's recommendation in the United Kingdom Insolvency Act 1986 and focuses on a debtor in the possession process. Gould (2010) defined the CVA as a formal insolvency process that requires a corporation to propose a debt repayment arrangement with its creditors. A CVA objective focuses on securing potential business in the long term. Furthermore, a CVA aims to establish an exact debt arrangement procedure to rehabilitate a viable company facing financial difficulties by meeting most creditors' interest (Walton et al., 2020). One of the significant benefits of implementing a CVA as a rescue mechanism is the lack of court involvement. The power to monitor the rescue process has evolved away from the court and towards the directors. The CVA process could be commenced by the directors of a financially distressed company with the appointment of a nominee who will be supervising the CVA procedure (Kastrinou, 2016).

In the UK, the Insolvency Act 1986 started the CVA with two types, namely, CVAs without and with a moratorium. The moratorium could be exercised for the CVA if the process is combined with the administration procedure. The appointment of a nominee to supervise the CVA process is required. In the event that the CVA is combined with administration, an administrator will be appointed to manage the company's affairs. This appointment seeks to protect the creditors' interest when the debtor company becomes insolvent. Nonetheless, Kastrinou (2016) revealed that insolvency practitioners did not warmly receive the CVA procedure as the company often initiated the CVA too little too late.

Corporate Voluntary Arrangement in Malaysia

The inclusion of CVAs in the corporate rescue mechanism appears as one of the strategic improvements for the survival of SMEs in Malaysia. The corporate rescue mechanism was introduced in the Companies Act 2016 as the previous Act does not provide viable options for small private companies except in terms of winding up process and liquidating the firms. As part of the corporate rescue mechanism, the CVA is useful for ailing companies to restructure their debts by obtaining their creditors' agreement instead of pursuing the winding-up process. If these small companies opted for closure, various problems would arise, such as lengthy legal procedures (Mar et al., 2013) and the high cost of the liquidation proceeding compared to reorganisation (Bris et al., 2006). Therefore, CVA implementation is timely, especially as the country faces the COVID-19 pandemic, for which many small companies face financial difficulties that force some of them to close their businesses. The CVA is the best option available to help save small private companies for them to continue operating and avoid being liquidated.

In Malaysia, a CVA may involve both a composition and a scheme of arrangement. Offers will be made to creditors' classes and not to an individual creditor (Nathan et al., 2019). Unfortunately, statistics from the Companies Commission of Malaysia documented only three CVA applications since the implementation of the corporate rescue mechanism in March 2018. This number indicates that CVA has failed to attract firm owners to take advantage of the benefits in terms of the lower cost and simpler process and procedure compared to other rescue options. Its underutilisation may be caused by some limitations of the CVA, such as the limited applicability of its implementation and the lack of familiarity with the CVA framework and procedure among potential participants. In the UK, the limited utility of CVA is caused by the moratorium's exclusive applicability to small companies. The CVA process has also been dominated by a modernised administration process (Kastrinou and Jacobs, 2016). Thus, exploring why this rescue option is not attracting companies under financial distress is vital to rescue those businesses.

Similarities and Differences of CVA in the UK and Malaysia

The CVA is a pre-insolvency proceeding that aims to restore a financially troubled company's financial position, especially for small companies. The CVA can be a beneficial restructuring or debt resolution tool for the company to reformulate its strategic plan and improve its financial standing. An efficient CVA procedure will help distressed companies ensure that the CVA could be implemented in the new environment. Moreover, the CVA focuses on the debtor possession process. The CVA is also known as a company voluntary arrangement in the UK. A limited company could file for a CVA in the UK when the company is insolvent and has the potential to be revived. The CVA is considered a cheaper insolvency procedure than judicial management, an administration procedure or winding up. The cost of the CVA depends on many factors such as the size of the company, the values of debts and number of creditors.

CVAs has been implemented in the UK since 1986 and were adopted in Malaysia since 2018 to improve the country's insolvency framework. A CVA requires creditor and shareholder approval for the agreement to bind all the creditors of the company. Creditor or shareholder votes on the CVA could be obtained through a physical meeting, virtual meeting or other electronic means. If the shareholders' decision varied from that of the creditors, the vote of the latter would prevail. Several similarities and differences occur between the CVA in Malaysia and the UK. Table 1 outlines the key similarities of the CVAs in the UK and Malaysia.

CVAs in the UK and Malaysia have several similarities. Firstly, a CVA in Malaysia is considered a mechanism to help a financially distressed company achieve a turnaround in its business, restructure its debts and avoid liquidation. This feature is similar to counterparts in the UK, except that the CVA is not to be used for financial restructuring in the latter. Secondly, the regulation that governs the provision related to the CVA in the UK is provided in Part I of the Insolvency Act 1986. Separate rules and guidelines also clearly define the process and procedures of CVA under the Insolvency (England and Wales) Rules 2016. For Malaysia, the Companies Act 2016 makes a specific provision in relation to CVA under Division 8 of the Companies Act 2016. Separate rules and guidelines applicable to the CVA are specified in the Companies (Corporate Rescue Mechanism) Rules 2018. Thirdly, a CVA may be initiated by the company directors, nominee, liquidator, receiver or insolvency practitioner. These persons would normally be required to make an application for a CVA. Fourthly, the insolvency practitioner may assist a company's director in preparing the CVA application and proposal to be submitted for member and creditor approval. Fifthly, another similarity entails the requirement for the CVA proposal plan to obtain at least 75% approval from creditors and a simple majority of members at special meetings. Sixthly, the person responsible for the implementation and supervision of the CVA is an insolvency practitioner. Seventhly, a CVA requires no court involvement in both countries. This feature is supposed to help enhance the efficiency of the CVA procedure.

Table 1
SIMILARITIES BETWEEN CVAS IN MALAYSIA AND THE UNITED KINGDOM

Criteria	United Kingdom	Malaysia
Definition	A CVA is a contractual arrangement between a financially distressed company and its creditors, with an insolvency practitioner's supervision. The CVA could not be	The CVA is a proposed voluntary arrangement to restructure a company's debts and which is supervised by an independent insolvency practitioner.

	used for financial restructuring.	
Regulation	i. Part I of the Insolvency Act 1986. ii. The Insolvency (England and Wales) Rules 2016.	i. Division 8 of the Companies Act 2016. ii. The Companies (Corporate Rescue Mechanism) Rules 2018
Initiator	The directors of a company, the nominee or insolvency practitioner, the administrator and the liquidator.	The directors, liquidator, judicial manager or official receiver of the company.
Proposal	An insolvency practitioner or nominee is required to assist the directors in preparing the CVA proposal. The proposal shall include a statement of the company's affairs on the following aspects: a. Particulars of the creditors, debts and other liabilities and assets of the company; and b. other information as may be prescribed.	The director works with the insolvency practitioner to prepare a proposal on debt restructuring and then submits the application together with a statement that the proposed debt restructuring has the potential to be approved and implemented and that the company has enough funds to continue its business during the moratorium period.
Approval	Members' meeting – a simple majority Creditors' meeting – 75% of unsecured creditors	Members' meeting – a simple majority Creditors' meeting – 75% of creditors
Process Manager	Nominee (Insolvency practitioner)	Nominee (Insolvency practitioner)
Court approval	This feature is not required. An insolvency practitioner is required to notify the Court of the result.	This feature is not required. An insolvency practitioner is only required to notify the Court of the result.

The main differences between the CVAs of the UK and Malaysia involve applicability, mode of application, moratorium and use of technology. Table 2 provides a summary of the differences between the CVAs in Malaysia and the UK. In the UK, the CVA is available to all limited companies regardless of private or public ownership. By contrast, the CVA in Malaysia is restricted not only to private companies, but also to companies that should not have a secured creditor. Next, the mode of application of the CVA in Malaysia is in writing via the filing of Form 1 to the Court (Companies (Corporate Rescue Mechanism) Rules, 2018). In the UK, no specific form exists for CVA application. The nominee should submit a written statement of the company's affairs to the Court within 28 days after the CVA proposal is submitted to the nominee. The trade association for the UK insolvency and restructuring professional, known as R3, proposes a standard form for the Covid19 CVA proposal to be used by SMEs. This standard form seeks to expedite the CVA process and save time and cost involved in CVAs.

Another difference is that a moratorium is unavailable for a company applying for the CVA in the UK unless the process is combined with the administration procedure. By contrast, a 28-day moratorium will be granted to a company once the application application of CVA in Malaysia has been submitted to the Court. The extension of the CVA period in Malaysia could be applied with 75% agreement from the creditors. The maximum duration for the moratorium is 60 days (Companies Act 2016, 2018). Finally, the online process is applicable in the UK when a company is permitted to conduct a virtual meeting or use electronic voting and other technological alternatives to conduct shareholder and creditor meetings. For Malaysia, the adoption of technological equipment is permitted if the company meetings are conducted at more than one venue under Section 327 of the Companies Act 2016. In 2020, the Securities Commission Malaysia issued a Guidance Note on the Conduct of General Meetings. This guideline serves as a standard process for conducting a virtual shareholders meeting. However, this guideline is only applicable to listed companies. The use of this guideline might also be extended for meetings of shareholders and creditors in private companies because the CVA in Malaysia is only applicable to private companies.

Table 2
THE DIFFERENCES BETWEEN CVAS IN MALAYSIA AND THE UNITED KINGDOM

Criteria	United Kingdom	Malaysia
Type of company	Limited companies (private and public company).	Private companies only (no secured charges).
Mode of application	Submission of nominee report with a statement of affairs to the Court within 28 days after the CVA proposal has been submitted to the nominee.	Filing of Form 1 to the Court (Companies (Corporate Rescue Mechanism) Rules, 2018).
Period of moratorium	No moratorium unless combined with the administration procedure.	28-day moratorium period.
Extension of moratorium	Unavailable unless combined with the administration procedure.	Subject to 75% creditor approval, and the maximum extension is 60 days.
Online Procedure	Only applicable to the procedure of the meetings. A company could use virtual meetings, electronic voting or any technological tools for conducting the creditor and shareholder meetings.	The use of a technological tool is allowed if the company meetings are conducted in more than one venue. Securities Commission Malaysia has issued a Guidance Note on the Conduct of General Meetings which outlines the guideline on virtual shareholder meetings. However, this guideline is applicable to listed companies.

Advantages and Limitations of the Corporate Voluntary Arrangement

Kastrinou (2016) asserted that the CVA should be a preferred approach because it is less cumbersome in terms of creditor voting than the scheme of an arrangement which requires the creditors to be divided into different categories. The CVA provides advantages as quick, relatively inexpensive (Pandit et al., 2000), flexible and free from judicial intervention. Pandit et al. (2000) reported that the CVA was mainly employed by small firms. The CVA could be a useful tool for recovery for a viable company if the fixed costs were funded and sufficient time provided for the process. They recommended that CVA success be measured by examining the number of companies that continue trading after entering a CVA.

Cook et al. (2011) further argued that CVA success has a relationship with reasonable prospects for recovery and supportive creditors. Moreover, Walters and Frisby (2011) asserted that a successful CVA could be measured by the majority acceptance of the CVA proposal and when the company remains active after CVA completion. They found that 27% of the companies were considered successful in implementing the CVA as these companies remain active in the industry. However, this success rate was unsatisfactory given that more than half of implemented CVA in 2006 were terminated prematurely. They also suggested that more studies are required to assess the need for a moratorium to ensure CVA success.

In terms of CVA effectiveness, Walton et al. (2020) reported their analysis of the completion of CVA implementation according to 552 CVAs commenced in 2013 in England and Wales. The authors found that 18.5% of CVAs were implemented entirely, 16.5% were continuing and 65% were dismissed without achieving CVA objectives. They also documented that only 20% of CVAs with moratorium is terminated compared to CVA without a moratorium. To utilise the moratorium, a company must combine the CVA procedure with administration, a situation which might incur more costs. Walton et al. (2020) suggested that the CVA completion period should be less than three years. Furthermore, directors' duties should be enhanced by including a role to identify financial distress at an initial stage.

The CVA in Europe is less appealing as insolvency practitioners do not appreciate it despite various successful implementations for some large firms. Kastrinou (2016) further clarified that the reason for the disfavour of the CVA is because of the low fee paid and the lack of awareness of CVA procedure among insolvency practitioners. The author also contemplated that the CVA will be prevalent when its process is paired with an application for administration. However, this combination might increase the company cost in completing the rescue process.

Overall, the CVA can be considered a cost-effective rescue mechanism if its limitations are recognised and improvement to the system is undertaken. More studies should be conducted to address the actual issues of CVA implementation. The necessary framework will be required to ensure that the CVA implementation is not burdening the company during a challenging and turbulent period.

CONCLUSION AND FUTURE RESEARCH

Despite the relatively high failure rate of the CVA, its implementation in Malaysia could be considered successful by measuring the acceptance of CVA proposal by creditors and shareholders as defined by Walters and Frisby (2011). Two companies that have applied for CVA, namely, M&M Consolidated Resources Sdn Bhd and Gorich Sdn Bhd, successfully found the investors and terminated the CVA by achieving its objective. Another company, Iflix Sdn Bhd, recently applied for a CVA and is currently in the moratorium phase. However, the acceptance of this mechanism as a viable option to rescue small private companies seems to be slow because of the CVA's limitations. This limitation should be addressed properly to ensure that more companies could recover from financial distress.

It is still too early to measure the success of the CVA in retaining company profit, ownership and management in Malaysia because it takes some time for a company to achieve a turnaround to normal conditions. However, results from three companies that have applied CVAs signify that the CVA can revive a distressed company. Amendment of the regulation to widen the utility of the CVA and more efforts to enhance participant familiarity with the procedure will be necessary to ensure this rescue mechanism's effectiveness. Furthermore, a perspective from insolvency practitioners, creditors and the companies' management on CVA implementation is crucial to obtain a comprehensive evaluation of the CVA for reviving financially distressed companies.

Furthermore, the directors should ensure that the CVA proposal manages to depict financial benefits to both creditors and shareholders to increase the likelihood of CVA approval. The terms in the CVA proposal should be feasible for the company to meet its debt obligations and gain more profit. Creditors might pursue legal action if any default for the repayment occurs because of the failure of the CVA. Therefore, an assessment of the company's financial position should be accurately conducted to produce realistic recommendations and strategies in the CVA proposal. As suggested by Walton et al. (2020), the directors should utilise an appropriate tool to identify financial difficulties early to ensure that the CVA application could be initiated promptly.

Furthermore, the integration of an online system for the CVA would maximise its usage in any situation and expedite the CVA process. The digital platform has become crucial in today's world to cope with many unforeseen circumstances. In the UK and Malaysia, the digital process for a CVA is limited to the procedure of the meetings. Issues of data protection and procedural uncertainties (Clifford and Van Der Sype, 2016) should be appropriately addressed to ensure that online CVA could be implemented effectively and efficiently. The European Union legal framework of secured online dispute resolution could be adopted for a better pre-insolvency online system.

This discussion serves as a preliminary review of CVA implementation to rehabilitate financially distressed companies. This work is conceptual, and some comparison has been made between the CVA in Malaysia and the UK. This research also suggests that an online operationalisation system should be adopted for the CVA in Malaysia. On the basis of the above discussion, more empirical research should be conducted on the CVA to evaluate its potential for a successful recovery. Future study in this field should explore the challenges and impacts of CVA implementation, especially from the perspective of the insolvency practitioners who are directly involved in the process. Further improvement to the regulations and guidelines on the CVA framework should be made by the Companies Commission of Malaysia to enhance the application and efficiency of the CVA process. It is hoped that in the near future, the CVA can be a better choice for a company facing financial difficulties, contribute to a better insolvency framework and increase Malaysia's global ranking in terms of business.

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