

6. INDICATORS TO ASSESS THE INFLUENCE OF THE STIGMA OF FAILURE

In this section we have developed indicators to assess the influence of the stigma of failure on the potential of previously failed entrepreneurs to start again and on entrepreneurship in general.

6.1. GENERAL KNOWLEDGE AND SILENCE

We draw attention to the fact that within the business and financial communities, the organisations targeted have an understanding of the technical notions of “bankruptcy”, “insolvency” and/or “cessation de paiements”, and the applicable legal regimes. The answers given to question 3 of the respective questionnaires reveals that most of the targeted communities have a knowledge of these notions and of the distinction between a business in distress and a business that has recovered from distress.

According to the answers received to the first question, and the interviews carried-out, the situation is totally different for those targeted organisations dealing with the general public, and consumers. Indeed, within the general (consumer) community, the answers given in the questionnaires showed that their general knowledge is limited to the notion of bankruptcy/business failure, but does not extend to the difference between insolvency and bankruptcy.

The relationship existing between the financial and business community can be considered as osmotic and transparent. However the situation is not the same in the case of those organisations dealing with general interests and consumers’ protection as they have no real link with the entrepreneurial culture. This situation prevents both consumers and small investors from being informed about “bankruptcy” and business in difficulty. Several organisations pointed out that consumers are only aware of bankruptcy when they are a direct victim of a bankruptcy case.

Often, within the general public community, the organisations targeted failed to respond to the questionnaires and interviews: 20 responses were received. During the interviews (most of which were carried out in the local language), the organisations were shown not to have a understanding or general awareness about the potential implications of bankruptcy in the consumer context. The silence or the lack of information should be considered as a strong indicator of ignorance of the implications of the bankruptcy and stigma for the general public. Unfortunately, these factors cannot be evaluated or considered scientifically or statistically. On the other hand, the business community appears to be the most “concerned” community with the issue and the survey: the questionnaires were answered with less reluctance and more ‘input’. All the organisations interviewed expressed an interest in providing input.

6.2. THE STIGMA.

Within the three targeted communities, in the vast majority of the Member States there is a strong stigma attached to the bankrupt entrepreneur. However, it is impossible to define national trends.

Both the financial and the business community indicated that a stigma surrounds the failure of a business (see answer 2 in the respective questionnaires). Indeed, both communities also observed that a distinction is made between a business in distress and a business that has recovered from distress. This has been underlined during the interviews and it is the official position they adopted in the questionnaires (see answer 3).

According to the answers to questions 5 and 7, the situation is quite different within the general community, where the distinction is not so clear, and where the stigma is as strong against the entrepreneur in difficulty or against the entrepreneur, who has previously failed.

During the interviews, the impression emerged that within the business community there is a kind of class complicity between entrepreneurs, namely within the crafters' communities: financial difficulties, and eventually honest bankruptcy, are considered as expected the normal risks of business life accidents during the business life. Therefore, there is no strong stigma vis-à-vis entrepreneurs having faced difficulties and / or honest bankrupts. This is confirmed by the answers given to question 15.

A difference in approach could be identified with regard to the issue of fraudulent bankruptcy as opposed to non-fraudulent bankruptcy (see answers 4, and 7 of respective questionnaires).

Both the business (within answer 25) and the financial community (within answer 35) considered the presence of stigmas in case of fraud, and further stated that these stigmas in case of fraudulent bankruptcy should not be eliminated.

In this context, it is worth noting that the public in general mentions fraud among the four most common reasons for failure, whereas it does not appear in the reasons expressed by the business and financial communities.

6.3. THE INFORMATION

According to answer 6 of respective questionnaires, within the business and the financial community, there is a large amount of information on the financial and legal status of entrepreneurs. The vast majority of the targeted organisation within the business community consider that this is information relevant for the business sector (answer 11 of the business community questionnaire). This could also be viewed as evidence of stigma. "*Why do we need so much information if we do not fear facing an entrepreneur in difficulty?*" this indicator, however, cannot be considered as entirely relevant given the ease of collecting and storing such information using modern technologies (please note the sources of information mentioned by the targeted organisations within the questionnaire relating to the business community in answer 6). The organisations confirmed that information regarding the financial status of entrepreneur has always been important in terms of quantity. Potentially, currently, the information is also closer to hand.

In terms of content, the organisations confirmed that in many cases, the sources of information do not specify the cause of the difficulties or the bankruptcy, and do not often differentiate between fraudulent bankruptcy, and non-fraudulent bankruptcy, as

stated by the targeted organisations of the business community within answers 10, and 11 of the questionnaires. Therefore, prudentially, the entrepreneur could cease any commercial relationship with an entrepreneur facing difficulties, whose status is recalled by private databanks.

Within the financial community, the majority of targeted organisations (please note answer 6 of the questionnaire) considered that the financial community does keep precise data (mainly accounting and general credit information) on the history of their clients and on their eventual financial difficulties.

With respect to the general community, the organisations attach a stigma merely because of the weakness of consumers vis-à-vis the entrepreneur and because the consumer does not generally consult this kind of information (see answers 12, and 13 of the questionnaire). Some organisations pointed out that often the price of this information discourages the single consumer. In addition to the questionnaires surveyed, the general ignorant attitude of the general community was further noted by the observation that their members rely almost exclusively on the media as a source of information on business failure. The non-availability of information was confirmed by the fact that targeted organisations do not keep any specific databank on bankruptcies/business failures.

6.4. THE REASONS FOR FAILURE

The answers received are not homogeneous and are inconsistent (please note answer 22 for the financial community, answer 13 for the business community, and answer 14 for the general community). All organisations stated that in many cases the reason for the bankruptcy of a single entrepreneur is not relevant to the level of stigma attached, because the reason is not known. Conversely, it was also stressed that information on the specific reasons for failure increasing the organisations' knowledge would provide an indispensable basis for an enlightened attitude towards these businesses.

It should be observed that the comparative analysis of the answers received from the business community with regard to large enterprises highlights that the most common highly ranked reason for business failure is management skills and poor management (please note answer 13 of the business community questionnaire). Obviously, these reasons are linked to the individual entrepreneur/ business management. Therefore, the stigma linked to business failure might follow the entrepreneur/ the business more closely than in cases of failure caused by external conditions.

Somewhat differently, the financial community (please note answer 22 for the financial community) mentioned causes for failure linked to the individual entrepreneur in the context of medium, small and micro enterprises, where the issue of management skills, relative youth or lack of experience of the entrepreneur were given high importance. On the other hand, the reasons for failure of large enterprises were more equally divided between management skills, financial causes, and external business conditions. Therefore, the stigma attached to the failure of a medium to micro enterprises seems stronger within the financial community – and may have an impact at the level of obtaining financial assistance. This position should be addressed in contrast to that of the business community, which tends to justify business failure

by financial difficulties of medium to micro enterprises, together with negative external business conditions.

6.5. THE ROLE OF THE ORGANISATIONS IN THE PREVENTION OF FAILURE

The general community does not have enough knowledge of the prevention measures. During the interviews, 2 Italian organisations declared themselves to be in favour of strengthening the control of the judicial bodies on business.

The financial community consider that an effective means for the detection of companies in possible financial difficulties, was achieved by their members both through overall control over the management of the target company/ presence of representatives at the management bodies of the target company, and through the close follow-up of the financial state of the company (see answer n° 23 of the questionnaire).

The position of the business and financial generally favour limiting the level of public intervention in business and promoting the banking intervention in the venture (see answer 37 of the questionnaire relating to the financial community; and answer 29 of the questionnaire referring to the business community). The business community generally appeared to regret the fact that the financial community does not provide the entrepreneurs with more support, whereas the financial community appeared to desire an increase in control over businesses, while rejecting both judicial and the financial control.

Within the business community, the targeted organisations answered (answer 33) in favour of placing the external control under the judicial authority and in many cases complementing this solution with additional solutions.

We would like to add that a Dutch organisation stressed that that the legislator could just decide to provide more assistance to business facing difficulties. Therefore, according to this organisation the legislator should encourage businesses in distress to ask for technical and legal assistance (answer 31 of the questionnaire relating to the business community).

6.6. DEALING WITH A BUSINESS FACING DIFFICULTIES / PREVIOUSLY FAILED

A reluctance appears in both the business (see answer n° 14 of the business questionnaires) community where the attitude of those organisations appears to be almost fifty/fifty ...: several targeted organisations pointed out that dealing with a business facing difficulties would normally be subject to the provision of guarantees, or even cash payments) and the financial communities with regard to the idea of dealing with a business facing difficulties, expressing the stigma that is attached to this situation (see answer 28 of the questionnaire relating to the financial community).

However, the business community is much more tolerant towards a business that has recovered from such difficulties. Indeed, according to the answers (see answer n° 14 of the business community) to the surveys, it appears that the attitude adopted by the

business community towards businesses facing difficulties would often depend upon the current economic situation, the importance of the customer relationship, the nature and level of difficulties encountered, and would be decided on a case by case basis. Although the general reluctance to deal with a business facing difficulties appears quite strong, all the targeted organisations unanimously agreed that their members would be willing to deal with a business that has recovered after failure.

All the targeted financial organisations agreed that the provision of new credit to a client facing business failure is subject to a case-by-case evaluation of the situation (see answer 28 of the questionnaire relating to the financial community). This unanimous attitude reflects the reluctance of the financial community towards businesses having faced financial difficulties, and the stigma being linked to these businesses.

The general community's approach is characterised by the consumers' indecision as to the attitude they should adopt.

6.7. THE FRESH START

On the whole, within the general community, there is a stigma attached to the entrepreneur who has previously failed (see answer 5 of the questionnaire relating to the general community). Within the business and financial communities, the stigma is relevant. However, it should be noted that according to the interviews carried-out within the crafters' sector the stigma is not as apparent, due to the kind of sector complicity that exists.

According to the interviews carried out and the result highlighted by the answer 23, and 24, a majority of the targeted organisations from the business community appear to be favourable to the idea of the promotion, by the legislator, of the opportunities for a fresh start for a business previously involved in bankruptcy, and to the correlative elimination of the stigma surrounding the business life of an entrepreneur previously involved in a bankruptcy. However, this is not the case in relation to the stigma surrounding fraudulent bankruptcy. Almost all of the targeted organisations agreed with the idea that failed entrepreneurs often learn from their mistakes and that they will be more successful in the future, thus expressing a positive "second chance" attitude, although such entrepreneurs would have to deal with the burden of the stigma of bankruptcy, making it more difficult to achieve good results (see answer 26 of the questionnaire relating to the business community).

The financial organisations appeared to have more reservations on the elimination of stigma with a view to a fresh start (see answer 34 of the questionnaire relating to the financial community). Most of the targeted financial organisations seem to be in favour of the promotion, by the legislator, of the opportunities for a fresh start for a business previously involved in bankruptcy. The targeted financial organisations seem to be divided on the issues of whether the legislator should work to eliminate the stigma affecting the business life of an entrepreneur previously involved in a bankruptcy, and of whether the legislator should promote a fresh start and eliminate stigma for fraudulently bankrupt persons. However, most targeted organisations positively answered that their members do believe that failed entrepreneurs often learn

from their mistakes and that they will be more successful in the future, thus expressing a certain degree of trust in failed entrepreneurs.

The financial community nevertheless almost unanimously agreed that banks (see answer 37 of the questionnaire relating to the financial community) do have an important role to play in the restart of a failed entrepreneur, and that their members would agree to the provision of new credit to an entrepreneur that has previously faced bankruptcy/ failed – although the latter would be subject to the provision of adequate securities and guarantees, and to the meeting of fixed goals expressed in the business plan.

6.8. THE EXTERNAL CONTROL

The targeted organisations expressed the need for a general increase in the level of preventative external control on businesses facing difficulties and on business in bankruptcy.

According to the interviews carried out the targeted organisations of the general community, solely the intervention of the judicial powers could limit the stigma and guarantee the respect of creditors rights.

According to the survey, the business community generally speaking does not appear to believe that the legislator should strengthen the level of control over the business life of an entrepreneur *previously* involved – as opposed to “*actually* facing difficulties” - in a bankruptcy experience. The majority of the targeted organisations assessed that the external control over a business facing difficulties should not be under the power of the judicial authorities, and even less under the control of creditors (see answers 33, and 34 of the questionnaire relating to the business community). The suggestion in favour of the appointment of a crisis manager was generally well received by the business community, which agreed that it would be considered an appropriate measure both by creditors and by employees of the business facing difficulties (see answer 35 of the questionnaire relating to the business community). German organisations pointed out that the appointment of the crisis manager is already possible.

According to answer 43 of the questionnaire relating to financial community, within the financial community, external control could work to limit the stigma. The control should be carried out by crisis managers, without the intervention of the judiciary authorities. In the course of the survey, the majority of the targeted organisations in the financial community appeared to believe that the entrepreneur does consider that the external manager can reduce the stigma on business facing difficulties. The majority of the financial targeted organisations rejected the idea of judicial supervision of the external control, to which several organisations seemed to prefer the control of creditors. The targeted organisations almost unanimously agreed that creditors of a business facing difficulties would consider the appointment of a crisis manager an appropriate measure.

An UK organisation underlined the fact that businesses do not consider that a crisis manager, appointed by the court (so called *court-appointed administrator*), actually works to reduce the stigma.

All communities associate the external control with the protection of the rights of creditors. Therefore, it should be concluded that the Stigma will exist if the rights of creditors are not satisfied.

6.9. LIST OF RELEVANT PERFORMANCE INDICATORS

- **“awareness”**

Definition: General knowledge in a particular community on basic distinctions associated with bankruptcy: what is bankruptcy/ business failure/insolvency, fraudulent/ non-fraudulent bankruptcy...

Objective: To determine to what extent the ignorance of a particular community around the notions associated with bankruptcy might result in particularly stigmatising attitudes in the situations.

Most striking answers by the three communities:

- *General community:* Knowledge does not extend to the difference between insolvency and bankruptcy. Limited awareness on the matter.
- *Business community:* Aware of the stigma that surrounds business failure. A distinction is made between business in distress and business that has recovered from distress.
- *Financial community:* Ibid.

- **“attitudes”**

Definition: General trends described by the targeted communities in reaction to situations of bankruptcy/ insolvency, specific case by case attitudes, for instance in the case of fraudulent bankruptcy.

Objective: To determine whether the reaction is in general positive or negative, whether it differs according to the community, whether it attaches a stigma to the failure and whether it might deter a failed business/ entrepreneur from starting a new business.

Most striking answers by the three communities:

- *General community:* Stigma attached to failure in general.
- *Business community:* More moderated: distinction is made between business in distress/ business having recovered from distress, and between fraudulent/ non-fraudulent bankruptcy.
- *Financial community:* Ibid.

- **“information”**

Definition: The sources of information relied on by the different communities.

Objective: How do the sources of information on business failure used by each community influence their knowledge on bankruptcy and their attitude towards bankrupt businesses.

Most striking answers by the three communities:

- *General community:* Media (no specific databanks); not well informed.
- *Business community:* Varied sources of information (colleagues, competitors, the business sector, media, credit/financial institutions).
- *Financial community:* Specific and efficient databanks.

- **“role in prevention”**

Definition: Whether the targeted community feels it has a role to play in the prevention of business failure.

Objective: To determine what this role would be, and whether it consists in an active approach: for the prevention of failure on the one hand, and for a fresh start on the other hand.

Most striking answers by the three communities:

- *General community:* Very limited role.
- *Business community:* Yes but generally not in favour of the following forms of intervention: to become involved in the management of a bankrupt person, to sell shares to a bankrupt person.
- *Financial community:* Yes. It could involve the presence of representatives of the organisation at the board of directors, overall control over management of the target company, and surveillance of the financial state of the company.

- **“dealing with bankrupt businesses”**

Definition: Whether the members of the targeted communities generally continue to deal with businesses that are facing difficulties/ bankruptcy, including: continuing business, continuing to provide credit, etc.

Objective: To determine on the one hand, whether businesses facing difficulties are provided with support from their business partners, from banks, etc, and on the other hand, whether a stigma is attached to a previously failed business, which would be revealed by its partners' reluctance to continue to deal with it.

Most striking answers by the three communities:

- *General community:* High deterrent effect: most consumer organisations would discourage their members from dealing with a business in difficulties, and would warn their members of the previous failure of a business.
- *Business community:* Relative willingness to deal with bankrupt businesses, depending on the specific case. Requirement of strong additional guarantees. Generally tolerant/open to dealing with a business in insolvency status.
- *Financial community:* Reluctance.

- **“fresh start”**

Definition: Whether previously failed/ bankrupt businesses are given a “second chance” and are provided with the possibility to start a new business.

Objective: To identify any stigma linked to the start of a new business by a previously failed/ bankrupt business.

Most striking answers by the three communities:

- *General community:* High deterrent effect: most consumer organisations would warn their members of the previous failure of a business. However, a favourable attitude was shown to legislative promotion of opportunities.
- *Business community:* Generally favourable to legislative promotion of the opportunities for a fresh start and the correlative elimination of stigma. Limit: in the case of fraudulent bankruptcy.
- *Financial community:* Generally favourable to legislative promotion of the opportunities for a fresh start but more reluctant to the correlative elimination of stigma. Banks' important role: provision of credit (subject to the provision of adequate securities).

- **“external control”**

Definition: Control which is/ could/ should be provided by domestic legislation on the business life of an entrepreneur either facing difficulties or previously involved in bankruptcy.

Objective: To identify the position of the three targeted communities with respect to the various forms of external control. This analysis involves the assessment of existing legislation in the area, including the level of satisfaction of the targeted communities in the member states, and the choice of the preferred form of external control (by the judicial authorities, by creditors...).

Most striking answers by the three communities:

- *General community:* N/A.
- *Business community:* Generally not in favour of legislative strengthening of the control over the business life of an entrepreneur previously involved in bankruptcy – as opposed to “actually” facing difficulties. In the latter case, the business community is generally reluctant to place the external control in the hands of the judicial authorities or under the control of creditors: the appointment of a crisis manager is preferred.
- *Financial community:* According to the financial community, the entrepreneur in many cases would consider that the external manager could reduce the stigma. The majority of the targeted organisations rejected judicial supervision, over which several organisations preferred the control of creditors. The appointment of a crisis manager was considered almost unanimously as an appropriate measure for the protection of creditors.