Chapter 04

Bankruptcy & liquidation: A contemporary approach
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Corporate Governance, Ethics, and Stakeholder Interests in Bankruptcy and Liquidation

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Learning Objectives
Upon finishing this chapter, the readers would be able to:

1. Find out the phases of bankruptcy of individuals and companies.
2. Describe voluntary and compulsory liquidation.
3. Differentiate voluntary liquidation of members and voluntary liquidation of creditors.
4. Know winding-up by order of court.
5. Explain the obligations, authority and the responsibility of liquidators and administrators.
6. Examine priorities, creditor ranking and distribution of assets.
7. Assess management practices including receivership, management and restructuring.
8. Evaluate difficulties in carrying out liquidation in Nigeria.

INTRODUCTION

The problem of corporate bankruptcy and its liquidation is not in a vacuum; it is strongly dependent on the quality of corporate governance and ethical leaders in companies. Poor governance systems, ineffective internal controls, and malpractices usually lead to financial miseries and ultimate bankruptcy.

According to Uwhejevwe-Togbolo[1,2,3] good governance does not mean adhering to the rules but developing a responsible corporate culture that expects risk and protects the value of the stakeholders. This chapter discusses how governance failures may lead to insolvency and vice versa how ethical leadership can avert or lessen the effect of bankruptcy.

The discussion is based on the sample of Nigerian companies that are quoted on the Nigerian Exchange Group (NGX) and draws upon experience of insolvency scandals in the world, including Enron, Lehman Brothers, and Oceanic Bank Nigeria.

DEVELOPMENT

The Concept of Corporate Governance in Insolvency Context

Corporate governance is the approach, by which organizations are guided, managed, and responsible (OECD, 2015).[4] Within the framework of insolvency, governance systems define the detection, reporting, and management of financial distress. At the time of the establishment, it was determined that most enterprises governance structure was inadequate and has the risk of governance and financial distress. Thus, it could be established that the governance structure of the most enterprise was insufficient at the time when it was created.

There are number of studies that show that the quality of governance affects risk profile and the probability of survival of a firm are numerous, such as the case of Jensen and Meckling [5] and Adegbite.[6] In this case bad governance can be determined as:

a. Incompetence in the board or management takeover.
b. Self-dealing and insider lending.
c. Poor risk management systems.
d. Failure to publish material financial information.

These governance lapses, when continued, will cause firms to become gradually insolvent, illiquid and unable to be trusted by their stakeholders because they will be forced to go bankrupt or be put into forced liquidation.

Board responsibility in financial crisis

Under CAMA 2020, the directors of companies are required to have fiduciary duties, act in good faith and exercise due care and to ensure the success of the company (Sections 305-307). In cases whereby there is a threat of insolvency, the directors are obliged to put into account the interest of the creditors, and not those of the shareholders (Section 507).

Lack of performing these obligations may lead to personal liability to wrongful trading or fraudulent trading (Sections 671 -675). This change in the responsibility is in line with the international standards, particularly the UK Insolvency Act 1986, Section 214.

Bankruptcy and Liquidation Ethical Aspects

Corporate failure and Business Ethics

Corporate management ethics does not only affect the performance of a firm but also the chances of insolvency. Market forces are not the main cause of most of the financial crashes but rather are due to moral hazard, greed, and lack of consideration to the interests of the stakeholders.[7]

In Nigeria, ethical deficiencies that have contributed to insolvency have comprised:

a. Financial reports are falsified (e.g., Cadbury Nigeria Plc scandal, 2006).
b. Director misappropriation of assets.
c. Loans within the banking industry having to do with insiders (Oceanic Bank, Intercontinental Bank).

Standards of Behavior and Ethical Supervision

Ethical leadership, transparency and integrity is required in the Nigerian Code of Corporate Governance (NCCG, 2018).[8] Board of directors should have ethics committees and whistle blowing structures. Lack of implementation of ethical standards enhances chances of going into bankruptcy.

ILO[9] also provides the essentiality of implementing ethical liquidation practices to avoid exploitation of creditors and workers when selling the assets.

Corporate Insolvency and the Stakeholder Theory

Theoretical Foundation

The Stakeholder theory of Freeman[10] assumes that it is not only the shareholders that have a duty with the corporation but also all the parties that are influenced in one way or another by the corporation activities, such as employees, creditors, customers, and community. Through

insolvency, such relations are even more crucial. The competing claims by stakeholders should be reduced by means of open and equitable liquidation.

Stakeholder Liquidation Hierarchy

Table 4.1. Stakeholder Liquidation Hierarchy

Stakeholder Group	Nature of Interest	Legal Standing in Liquidation
Secured Creditors	Possess fixed or floating charges on assets	Priority rights under CAMA s.667
Preferential Creditors	Employees, tax authorities	Paid before unsecured creditors
Unsecured Creditors	Suppliers, trade creditors	Paid from residual value
Shareholders	Residual claimants	Paid last, if any balance remains
Employees	Entitled to unpaid wages and benefits	Protected by Labour Act and CAMA
Government	Tax obligations, regulatory interests	Acts as preferential creditor

This hierarchy ensures order and predictability in debt repayment, which enhances market confidence and fairness.[11]

The Auditors and Corporate Monitors

Auditors are very important in the identification of insolvency early signs. ISA 570 on International Standard on Auditing states that audit firm should assess the assumptions of going concern and report any uncertainties that are material.

In Nigeria, CAMA 2020, Section 401 requires auditors to disclose their reports to shareholders if financial statements are not based on true and fair views. Lack of this amounts to negligence.

In Cadbury Nigeria Plc v, auditor complicity was manifested. SEC (2008), in which, the financial overstatements have gone unnoticed over years and hence leading to a meltdown of investor confidence. In this case, the external auditors, Akintola Williams Deloitte (AWD), were found to have participated in the financial fraud involving Cadbury Nigeria Plc by professional incompetence and a lack of professional skepticism. After investigating, the Nigerian Securities and Exchange Commission (SEC) found in its 2008 report that AWD had neglected its responsibilities, which resulted in the company's accounts being overstated by about ₦13 billion (roughly $85 million at the time) between 2002 and 2006.

Therefore, incorporation of ethical auditing, external controls, and governance reforms continues to have critical role to play in insolvency prevention.

Corporate Governance in Insolvency Cases in Nigeria

Case Study 1: Oceanic bank international plc

The failure of Oceanic Bank in 2010 had revealed some of the worst governance flaws, such as insider lending, the ineffectiveness of risk control and complacency in the board. The central Bank of Nigeria (CBN) stepped in and the ultimate acquisition of Ecobank was made possible.

The case shows how governmental laxity and bankruptcy are connected when directors did not ensure that there was capital sufficiency and disclosure.

Case Study 2: Cadbury Nigeria Plc

Cadbury accounting scandal of 2006 showed earnings overstated by 13 billion 2006. Internal control failures and weaknesses in the auditor oversight were revealed through investigations. The case redefined the discourse of corporate ethics in Nigeria even though Cadbury was not liquidated.

Case Study 3: NITEL Liquidation.

The Nigerian Telecommunications Limited (NITEL) liquidation was a manifestation of the insolvency problem of the public sector inefficiency, bad governance and the lack of innovation. It also emphasized on the necessity of open privatization and liquidation of the state-owned enterprises.

It should be recall that all the cases are not discussed in detailed, however, scholars can make more research findings to get the detailed cases.

Risk Management Framework on Governance in Insolvency Prevention.

The central aspect of prevention of insolvency is risk management. The CAMA 2020 and the NCCG [8] mandate boards to have risk committees and move towards the adoption of enterprise risk management (ERM) systems.

The scheme below presents the major governance measures to prevent insolvency:

Conceptual Diagram

This model focuses on active governance, through which risk signals cause corrective measures to be taken before the situation of insolvency deteriorates.

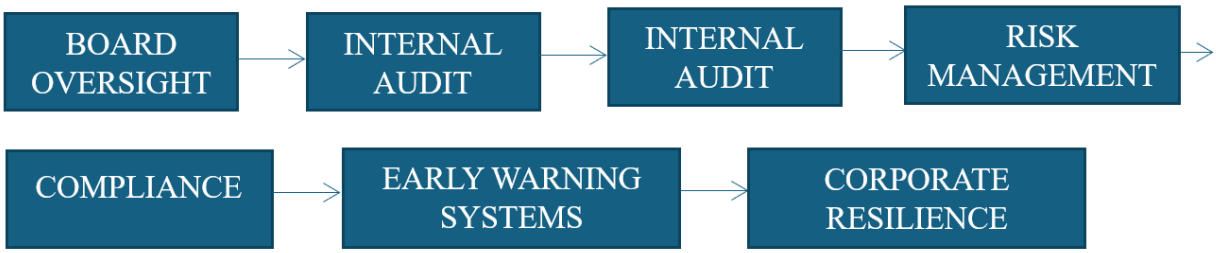

Figure 4.1. Framework of Governance-Based Insolvency Prevention

Ethical Liquidation Practices

Ethical liquidation will be associated with open valuation, fair allocation, and responsibility. Protection of the rights of workers and community welfare in case of liquidation is preached by ILO.[9]

The critical ethical standards are:

a. Independent professional fair valuation of assets.
b. Creditor notification in time.
c. Prevention of insider trading or misappropriation of assets.
d. Candid reporting to the regulators (CAC, NDIC, or court).

Non-adherence to these ethics can attract a professional penalty, a criminal charge, or a

tarnished image.

International Perspectives on Governance and Insolvency

Table 4.2. International Perspectives on Governance and Insolvency

Country	Key Governance Reforms	Insolvency Lessons
United Kingdom	Strengthened director duties post-Enron via Companies Act 2006	Directors' accountability during distress is crucial
United States	Sarbanes-Oxley Act (2002) enhances audit independence	Ethical auditing prevents hidden insolvency
South Africa	King IV Code integrates ethics and sustainability	Governance reform supports business rescue
Nigeria	NCCG (2018) and CAMA (2020) reforms	Implementation and enforcement remain weak

The world experience demonstrates that the ethics and transparency of governance are not some ideal principles but the conditions of the effective recovery of enterprises.

Governance and Ethical Compliance issues

Nigerian companies are challenged by the ongoing governance issues, such as:

1. Negligent adherence to governance codes (NCCG is not obligatory).
2. Board conflict of interest (insider domination).
3. Weak protection to whistle-blowers.
4. Unethical behavior which is tolerated culturally.
5. Poor punishment of misconduct among directors.

Adegbite and Nakajima[12] suppose that the effectiveness of governance is less functional, but rather symbolic in Nigeria and it takes a stronger institutional will.

Institutional and Policy Recommendations

The following are the based institutional and policy recommendations:

1. Ethics qualification of directors and insolvency practitioners to be mandatory.
2. Increased responsibility of the Financial Reporting Council (FRCN) on ethical matters.
3. Inclusion of ESG (Environmental, Social and Governance) requirements in assessment of liquidation.
4. Courts to reform and speed up instances of misconduct of directors.
5. Education programs of stakeholders to enhance culture of accountability.

SUMMARY

This chapter has shown that corporate governance and ethics is core in the interpretation of the effects of bankruptcy and liquidation. Failure of governance is usual leading to insolvency, whereas ethical leadership may foster recovery and equitable liquidation.

Insufficient strength in enforcement, the development of ethical boardroom culture, and the institutionalization of transparency are the case in point that can be illustrated by the Nigerian experience. The chapter forms a connection between the legal provisions and human behaviour in collapse of corporations.

REVIEW QUESTIONS

1. Describe how corporate governance is related to insolvency.
2. Talk about ethical responsibilities of directors in the liquidation.
3. Exam the effect of the collapse of Oceanic Bank as a governance failure.
4. Explain the role played by the stakeholder theory in informing liquidation ethics.
5. Suggest three reforms of governance to avoid insolvency in Nigeria.

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