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SME Financial Status Analysis and The Essential Requirement for Financial, Operational and Legal Restructuring
(In Light of the Lebanese Legal System)

Tala Zein, Doctor in Law, Associate Professor in Business Law and the Assistant Dean of the Faculty of Law and Political Science at Beirut Arab University (BAU)

Abstract

Small and medium enterprises are important pillars in every economy, but in terms of financial performance some of them are inherently more exposed to financial volatility. Financial crisis affecting enterprises is predominantly caused internally and it endangers the continued existence of the business. This article presents an integrative approach that correlates the financial performance of an enterprise with the need to develop and implement a compatible and constructive restructuring plan, therefore, a broad range of fundamental processes will be introduced, explained and analyzed.

For this purpose, we shall first define in this monograph the financial statements of an enterprise and interpret their content inclusive of financial transactions and operations. Furthermore, we shall describe how to evaluate the financial standing of an enterprise and its financial performance. The financial evaluation process will be accomplished by means of an enterprise's Financial statements analysis using ratio analytical techniques as a financial key performance indicator (KPI) or metrics, to track, measure and analyze enterprise financial health and assess its economic viability; a case study will be employed to focus on the computation methods and techniques.

Enterprises showing financial turmoil as a consequence of financial statements analysis will undergo a Restructuring process in order to avoid insolvency and business failure. Financial and operational restructuring are effective ways to assist small and medium enterprises improving their capital structure and re-organizing their operations. Accordingly, the last part of this paper will focus on the paramount importance of the legal aspect of restructuring, the criteria to validate a restructuring process and the potential reasons of enterprise's financial distress. The latter will culminate with the development of a restructuring plan that includes a set of remedial steps and recovery measures determined in order to ensure the reasonable efficiency of the enterprise, its products and services.

Key Words: Financial statement - balance sheet - ratio analysis - legal restructuring - restructuring plan

1 INTRODUCTION

In a financially challenging period, a closer look at an enterprise's financial position and results of its operations is crucial in order to measure and develop timely responses to financial turmoil or the prospect of insolvency.

Financial information is used in a wide range of business decisions. The Financial Statement Analysis process is intended to provide an understanding of the components of the financial statements in order to use this information to evaluate an enterprise's financial status. Therefore, the analysis and interpretation of financial statements will help to build better judgment concerning the company's financial performance. The techniques employed in this article to evaluate the financial performance of companies include but are not limited to: Liquidity ratios, Asset management ratios, Debt management ratios and profitability ratios. The computed ratios of an enterprise should also be compared to the industry average ratios to evaluate its efficiency.

Furthermore, we shall define in this article the restructuring process, display its legal aspect and formal procedural steps, and mention the proposed remedial and recovery measures in an integrated restructuring plan.

2 FINANCIAL STATEMENTS - DEFINITION AND CONTENT

Financial statements are written records that convey the business activities and the financial performance of an enterprise. Financial statements explicitly display the cash flow generated by an enterprise and the ability of an enterprise to meet its payment obligations. Investors, creditors, financial analysts and auditors rely on financial data recorded in financial statements to analyze the financial performance of an enterprise, evaluate its financial health and make predictions about its future direction and whether financial and operational restructuring is needed[1]. Financial statements are usually prepared in the following order as shown in Figure 01.

[1] J. PRATT and M-F. PETERS, *Financial accounting in an economic context*, Wiley, 11th ed., 2016, p. 177.

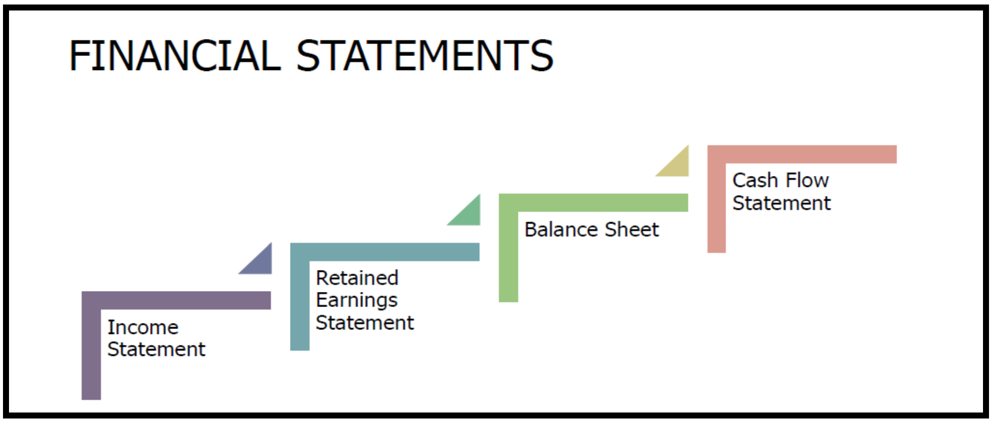

Figure 1. Enterprise Financial Statements

2.1 Income Statement

The Income statement primarily focuses on enterprise revenues and expenses over a period of time. Once expenses are subtracted from revenues, the income statement produces an enterprise profit figure called Net Income or loss figure called Net Loss[2].

- ❖ Income statement calculation:

  Net Income or Net Loss = Revenues - Expenses

  = Gross Profit - Total Expenses

Z Enterprise **Income Statement for the year ended December 30, 2021 and Dec 30, 2020 - in Thousand $**				
			Dec, 2021	**Dec, 2020**
(a)	Net sales or Net revenues	$	1,265	1,340
(b)	Cost of sales or cost of goods sold (COGS)		410	434
(c)	**Gross Profit = (a) - (b)**		**855**	**906**
(d)	Selling and Operating Expenses		573	564
(e)	General and Administrative Expenses		286	252
(f)	Other Expenses (Interest Expense, Gain or Loss on Foreign currency etc..)		15	15
(g)	**Operating Expenses = (d) + (e) + (f)**		**874**	**831**
(h)	**Income from Operations or EBIT = (c) - (g)**		**(19)**	**75**
(i)	Provision for Interest Expense		20	28
(k)	Provision for Income Tax expense		11	15
★	**Net Income = (h) - (i) - (k)**	$	**(50)**	**32**

Figure 2. Income Statement - indicative form

[2] T. STOBIERSKI, "Financial statement analysis: the basics for non-accountants", ‹https://online.hbs.edu/blog/post/financial-statement-analysis›, consulted on March 5, 2023.

- Gross Profit is equivalent to Gross Income
- Net Income is equivalent to Net Profit or Net Loss
- EBIT = Earnings Before Interest and Taxes

For an enterprise to be profitable, all its expenses must be lower than its revenues. In other words, the revenues must be substantial enough to settle all the expenses and compensate the employees. When this does not happen and the expenses exceed the revenues, the company incurs a Net Loss (as shown in Figure 02 - Z Enterprise Income statement / December 2021). If the Net Loss extends for more than one year or accounting period, it is a red flag that could indicate an enterprise is experiencing financial distress, or is about to in the near-term, hence it may be subject to restructuring to modify its operational and financial aspects.

2.2 Balance sheet statement

The balance sheet is designed to communicate the "book value" of an enterprise. It is a simple accounting form displaying the amount of all the enterprise' assets, liabilities and shareholders' equity. The balance sheet offers auditors, investors, creditors and analysts an overview and a quick snapshot of how an enterprise is performing and expects to perform[3]. Balance sheets are divided into three parts: Assets, Liabilities and Shareholders' Equity, where:

Assets = Liabilities + Shareholders' Equity

2.2.1 Assets - Definition and examples

Assets are anything the enterprise owns which has a quantifiable value and are listed in a balance sheet in order of liquidity, that is, how quickly they are used up or converted into cash. Enterprise Assets are described in Table 01[4].

Table 1 Assets Type and Example

Assets Type as classified on Balance Sheet	Example
Current Assets	
1. Cash and cash equivalent	Savings, bills and certificate of deposit
2. Short-term investments or marketable securities	Stocks, bonds, REITS
3. Accounts-receivable	Money owed from customers
4. Inventory	Items intended to sell such as merchandise goods that are acquired by retailer or

[3] J. PRATT and F.M. PETERS, *Financial accounting in an economic context*, p. 39.
[4] G. MOTT, *Accounting for non-accountants: A manual for managers and students*, Kogan Page, 8th ed., 2012, p. 40.

	wholesaler from suppliers, with the intent of selling the goods to third party.
Non-Current Assets (or long-lived assets)	
a. Tangible Assets such as Fixed Assets	Property, Plant and equipment
b. Intangible assets are assets that have no physical substance	Patent, Goodwill, Copyright, Trademarks, Brands and Intellectual property.

2.2.2 Liabilities - Definition and examples

Liabilities refer to legal debts an enterprise owes to creditors. Liabilities may be defined as debts or obligations arising from past transactions or events that require settlement at a future date[5] and are created when an enterprise: Buys goods and services on credit, Obtains short-term loans to cover gaps in cash flows or Issues long-term debt to obtain money for expansion. Enterprises divide liabilities on balance sheet into two main categories; Current Liabilities and Long-term liabilities help financial statement users and managers know when liabilities must be repaid,

Table 2 Liabilities Type and Examples

Liabilities Category as classified on Balance Sheet	Example
Current Liabilities Current Liabilities are defined as short-term obligations to be paid or be fulfilled with Company current assets within one year.	1. Accounts Payable are short-term obligations due to suppliers for purchases of merchandise or for any goods and Services. 2. Salary and wages payable (accrued Expenses 3. Interest Payable
Non-Current-Liabilities Non-current liabilities or long-term liabilities are obligations and long-term debts expected to require payment over a period of time beyond the current year. Long-term liabilities are used by many enterprises to finance their operations and growth opportunities.	1. Notes Payable - are direct borrowings or arrangements to finance the purchase of assets 2. Bonds payable - are notes issued by a company or an enterprise to debt investors. Bonds are financial instruments that outline the future payments an enterprise promise to make in exchange for receiving a sum of money now.

2.2.3 Shareholders' Equity - Definition and examples

Shareholders' Equity is a term that generally refers to the net worth of an enterprise. It reflects the amount of money that would be left if all the enterprise's assets were sold and all the

[5] J. PRATT and F.M. PETERS, *Financial accounting in an economic context*, p. 405.

enterprise's liabilities paid. In other words, if we subtract the total Liabilities recorded on the balance sheet from the Total Assets we are left with shareholders' Equity, where:

Assets = Liabilities + Shareholders' Equity (As recorded on Balance sheet) and,

Shareholders' Equity= Assets - Liabilities

Essentially, this is the Book Value of the shareholders' stake in the company or enterprise whether they are private owner or public investors[6]. Shareholders' Equity is principally made up of:

- ❖ Contributed capital: also known as Paid-In-Capital, is the cash and other assets that shareholders have given a company over time in exchange for stocks.
- ❖ Retained earnings: a surplus amount of money retained from Earned capital and held by an enterprise in reserve in order to utilize it to: invest to expand business operations, repay an outstanding loan (Debts), Invest to launch new products, distribute dividends (a dividend is an amount paid in cash to those Investors holding the company's stock on a specific date).

[6] A. J. CASHIN and J.J. LERNER, *Principles of Accounting*, McGraw-Hill, 5th ed., 2009, p. 259.

Z Enterprise Balance Sheet - in thousands $ As of December 30, 2021 and December 30, 2020			
Assets			
Current Assets		**December 30, 2021**	**December 30, 2020**
Cash and Cash equivalents	$	24	36
Accouns Receivable		225	190
Inventory		152	108
a) **Total Current Assets**		401	334
Non-Current Assets			
Intangible and other assets		100	100
Property and Equipment		893	931
Accumulated depreciation		(443)	(355)
b) **Total Non-Current Assets**		550	676
Total Assets = (a) + (b)	$	**951**	**1,010**
Liabilities and Shareholders's Equity			
Current Liabilities			
Accounts Payable		115	104
Accrued Expenses (Salaries & Wages, Rent etc..)		310	285
Other Liabiliies		50	50
c) **Total Current Liabilities**		475	439
Non-Current Liabilities			
Notes Payable		192	221
Bonds payable		137	153
d) **Total Non-Current Liabilities**		329	374
e) **Total Liabilities = (c) + (d)**		804	813
Stockholders' Equity			
Common stock		129	129
Retained Earnings		18	68
f) **Total Shareholders' Equity**		147	197
Total Liabilities and Shareholders' Equity = (e) + (f)		**951**	**1,010**

Figure 3. Balance Sheet - indicative form

- Total Assets Should always Equal to = Total Liabilities + Shareholders' Equity

2.3 Cash Flow Statement

The Cash Flow Statement summarizes how a business's operating, investing and financing activities caused enterprise cash balance to change over a particular period of time. An enterprise can only operate as long as it has the money to cover its expenses. Therefore, Cash Flow reflects an enterprise's ability to operate in both the short-term and the long-term, and is used by investors, creditors and financial analysts to determine whether a company or enterprise has good financial standing. It also used by auditors and regulators to evaluate the company financial health and sustainability and whether re-structuring is required to avoid insolvency or business failure[7].

[7] T. STOBIERSK, "How to read & understand a cash flow statement", ‹https://online.hbs.edu/blog/post/how-to-read-a-cash-flow-statement›, consulted on March 10, 2023.

The cash flow statement as shown in Figure 04 can typically be split into three sections[8]:

Cash Flow from Operating activities: this section of cash flow shows the cash received and paid for day-to-day business activities with customers, suppliers, employees and others.

1. Cash Flow from investing activities: this section of cash flow shows cash paid and received from buying and selling investments and long-term assets.
2. Cash Flow from financing activities: this section of cash flow shows cash received and paid from lenders and shareholders.

Z Enterprise Statement of cash flows for the year ended December 30, 2021	
	Dec, 2021
a) Cash flow provided by (used in) operating activities	**(5)**
Net Income	(50)
Current assets	(79)
Depreciation	88
Current liabilities	36
b) Cash flow provided by (used in) investing activities	**38**
Purchase of property and equipment	38
c) Cash flow provided by (used in) financing activities	**(45)**
d) Net increase (decrease) in cash & cash equivalent = (a) + (b) + (c)	**(12)**
Cash and cash equivalent, beginning of year	**36**
Cash and cash equivalent, end of year	**24**

Figure 4. Cash Flow Statement - indicative form

We can conclude from the cash flow statement in Figure 04, that the net cash flow for the year 2021 has decreased by$(12,000), this is a warning sign that could indicate an enterprise is encountering financial or operational distress or is about in the near-term. Consequently, it may be subject to restructuring to enable the business to become more integrated and profitable, thus increasing its cash flow[9]. The reason small businesses fail overwhelmingly includes cash flow issues which is mainly due to poor cash flow management and poor understanding of cash flow. Furthermore, it is important to understand the difference between profit and cash, profit

[8] C. B. MURPHY, "what is cash flow statement: what it is and examples", ‹https://www.investopedia.com›, consulted on the 1st of March 2023.

[9] J. OHLSON and J.-k. AIER, "On the analysis of Firm's cash flows", ‹https://www.researchgate.net/publication/228302176_On_the_Analysis_of_Firms%27_Cash_Flows›, consulted on January 10, 2023.

is an accounting principle for financial gain, whereas cash is the actual money at your disposal[10].

Investors, financial analysts, creditors, auditors, courts and their nominated agents rely on the data and information displayed in the financial statements which are analyzed using analytical techniques; Relevant results are evaluated and compared with similar results from previous years and with competitors' results and performance, to determine whether the condition of the business is improving or worsening. In the forthcoming Section 03, we shall explain how to analyze and interpret financial statements and subsequently assess the financial status and economic viability of an enterprise.

3 FINANCIAL STATEMENT ANALYSIS AND MEASURING OF ENTERPRISE PERFORMANCE

Financial Statement Analysis is the process of analyzing an enterprise's various financial documents in order to evaluate its financial status and make necessary decisions about the business[11]. Financial data contained within each financial statement is analyzed through analytical techniques to offer insight into the financial health of the enterprise and determine its capacity to persist and progress toward its key objectives and business goals.

Analysis is largely a matter of establishing significant relationships and identifying changes and trends. A widely used analytical technique which analyzes various financial statements is the <u>Ratio Analysis Technique</u>. Results associated with the Ratio analysis are presented in comparative form for more than one accounting period or accounting year, where results appear side by side in vertical columns[12].

3.1 Measures of short-term liquidity - Liquidity Ratios

Liquidity ratios are an important class of financial metrics used to determine an enterprise's ability to pay current or short-term bills, current debts and continuing obligations as they become due, without raising external capital[13]. Liquidity ratios reveals whether an enterprise has enough working capital or cash &cash equivalent to settle all payments due. We shall refer

[10] T. TSE, "*Corporate finance, the basics, Routledge*", ‹https://www.coursehero.com/file/170707736/Corporate-Finance-Book-1-2021pdf›, consulted on February 3, 2023.
[11] E. NOREEN, P. BREWER and R. GARRISON, *Managerial Accounting for Managers*, McGraw-Hill, 5th ed., 2019, p. 240.
[12] www.gsb.columbia.edu/Ceasa (Center of excellence in accounting & security analysis); https://aaahq.org. (American Accounting Association).
[13] C. D. COSTEA and F. HOSTIUC, "The liquidity ratios and their significance in the financial equilibrium of the firms." *The USV Annals of Economics and Public Administration* 2009, p. 252-261.

to the Z Enterprise's Income statement in Figure 02 and Balance Sheet in Figure 03 plus the cash flow statement in Figure 04 to compute, analyze and interpret all ratios.

3.1.1 Current and Quick ratios - Computation and interpretation

The current ratio measures a company's ability to pay current liabilities with its current assets, such as cash, inventory, and receivables. It reflects a company's ability to generate enough cash to pay-off all its debts once they become due. In many cases, a company with a current ratio of less than 1.00 does not have enough capital on hand to meet its short-term obligations if they were all due at immediately, where as a current ratio greater than 1.00 indicates that the company has the financial resources to remain solvent in the short term[14].

Current ratio $= \frac{Current\ Assets}{Current\ Liabilities}$, where:

- Current assets and current liabilities are displayed on the Enterprise Balance Sheet statement.

Table 3: Z Current ratio for the year 2021 and 2020

Year	2021	2020
(a) Current assets	401	334
(b) Current liabilities	475	439
Current ratio = (a)÷(b)	0.85	0.76

For many years, the guidelines for the minimum current ratio have been 1 - 1.5. A comparison of the enterprise's current ratio with the previous period and with industry averages, will help to determine if the ratio is high or low[15].

Quick Ratio: Quick ratio measures an enterprise's capacity to pay its current liabilities without the need to sell its inventory or obtain additional financing. Quick assets are defined as the current assets excluding Inventory.

- Quick ratio $= \frac{QuickAssets}{CurrentLiabilities}$, where Quick assets = Current assets - Inventory
- Quick assets and current liabilities are displayed on the Balance Sheet statement.

Table 4 Quick ratio for the year 2021 and 2020

Year	2021	2020

[14] M. FRIDSON and F. ALVAREZ, *Financial statement analysis: A Practitioner's Guide*, Wiley, 5th ed., 2022, p. 128.
[15] G. GALLINGER, "The Current and Quick Ratios: Do They Stand up to Scrutiny? Drop the Current Ratio – Pick up the CCC", *Business Credit, New York* May 1997, vol. 9, p. 22-23.

(a) Quick assets	249	226
(b) Current liabilities	475	439
<u>Quick ratio</u> = (a)÷(b)	0.53	0.5

For many years, the guideline for the minimum quick ratio was 1. A comparison should be made with the enterprise's past quick ratio and with major competitors and the industry averages to check if the ratio is acceptable or needs improvement. Z Enterprise shows weak current and quick ratios, with an average current ratio = 0.8 and an average quick ratio = 0.51. Therefore, Z Enterprise is unable to fully pay-off their current liabilities with its assets or liquid assets in the short-term. Hence, Z enterprise may become subject to the restructuring of its operations and financial activities to boost its liquidity ratios and enhance its liquidity conditions.

3.2 Asset Management Ratios

Asset management ratios are a group of metrics that show how an enterprise has used or managed its assets in generating revenues. These ratios can determine the efficiency and effectiveness of the company's asset management. The higher the asset management ratios, the more efficient a company is at generating revenue from its assets. Conversely, if a company has a low asset management ratio, it indicates it is not efficiently using its assets to generate sales[16].

3.2.1 Accounts Receivable Turnover - Computation and Interpretation

The receivables turnover ratio is an accounting measure used to quantify a company's effectiveness in collecting its accounts receivable, or the money owed by customers or clients. This ratio measures how well a company uses and manages the credit it extends to customers and how quickly that short-term debt is collected or is paid[17]. A higher accounts receivable turnover means an efficient collection of payments moreover poor accounts receivable turnover indicates a poor cash flow collection which leads to a slowdown in cash flow, this factor will inhibit an enterprise's ability to invest and perform properly its operational activities.

- Z enterprise Accounts Receivable Turnover Ratio = $\frac{NetSales}{AverageAccountsReceivable} = \frac{1265}{208}$= 6x
- <u>Average Accounts Receivable</u> is the average between an enterprise starting accounts receivable balance and ending accounts receivable balance = (190+225)/2 = 208.

[16] E. NOREEN, P. BREWER and R. GARRISON, *Managerial Accounting for Managers*, p. 261.
[17] W. KENTON, "Corporate finance & Accounting financial analysis", ‹https://gcwgandhinagar.com›, consulted on January 9, 2023.

Table 5 Accounts receivable turnover for the year 2021

Year	2021
(a) Net sales or revenues (Income statement)	1,265
(b) Average Account receivables (Balance sheet)	208
Account receivables Turnover = (a) ÷ (b)	6X
Average number of days to collect accounts receivable = 365/Account receivables Turnover	61

3.2.2 Inventory Turnover - Computation and interpretation

Inventory turnover measures how many times in a given period a company is able to sell a quantity of goods equal to its average inventory and replace the inventories that were sold. A slow turnover implies weak sales and possibly excess inventory[18].

- Z enterprise Inventory Turnover Ratio $= \frac{Cost\ Of\ Goods\ Sold}{Average\ Inventory} = \frac{410}{130} = 3.15x$
- Average Inventory is the average between an enterprise starting Inventory balance and ending Inventory balance = (108+152)/2 = 130

Table 6 Inventory Turnover for the year 2021

Year	2021
(a) Cost of Goods Sold (COGS) (Income statement)	410
(b) Average Inventory (Balance sheet)	130
Inventory Turnover = (a) ÷ (b)	3.15 X
Average number of days to sell Inventory = 365/Inventory Turnover	116

Z Enterprise needs to be more effective in collecting their account receivables or money owed by customers or clients and improve their accounts receivable turnover or ratio in order to increase their current assets especially cash and cash equivalent and subsequently boost their short-term liquidity. A low receivables turnover ratio is not a good thing as it may be due to an inadequate collection process, bad credit policies, or customers who are not financially viable or creditworthy; therefore, cash flow will be adversely affected. Furthermore, the company should

[18] P. DRAKELEY and T. PERRERA, "Inventory optimization adoption amongst SMEs", ‹https://www.researchgate.net/publication/365333407_Inventory_Optimisation_Adoption_Amongst_SMEs›, consulted on May 4, 2023.

strive to increase its Inventory turnover and shorten the average number of days to sell inventory in order to avoid excess Inventory. The Inventory turnover or ratio is often used as a metric of overall operational efficiency. The longer an item is held, the higher the holding cost will be, and the fewer reasons consumers will have to return to the shop for new items; this will adversely affect the sales, profit generated, plus the return on investment and cash inflow.

3.3 Debt management Ratios

Debt management ratios measure the credit risk of the firm and its ability to pay its principal debt and the related cost of debt. The debt management ratios measure the enterprise's risk and likelihood of default. Debt ratios are of utmost importance to evaluate the viability of an enterprise and a valuable input towards the restructuring process.

3.3.1 Debt Ratio - Computation and Interpretation

The debt ratio indicates the firm's long-term debt-paying ability. The debt ratio indicates the percentage of assets financed by creditors and helps to determine how well creditors are protected in case of insolvency[19].

Table 7 Debt Ratio

Year	2021	2020
a) Total Liabilities	804	813
b) Total Assets	951	1010
Debt Ratio = (a) ÷ (b)	0.84	0.8

With an average debt ratio equal 0.82, Z Enterprise is relying on debt to finance and purchase assets, as 82% of its assets are acquired through debts, this is an indication of poor operations and management decisions, and if protracted, and debt ratio exceeds 1 excessively, immediate operational and financial restructuring processes should be implemented to avert business failure[20].

3.3.2 Debt/Equity ratio - Computation and Interpretation

The debt/Equity ratio is another computation that determines the enterprise's long-term debt paying ability. The debt to equity (D/E) ratio is used to evaluate a company's financial leverage and is calculated by dividing a company’s total liabilities by its shareholder equity. The D/E ratio is an important metric used in corporate finance. It is a measure of the degree to which a company

[19] E. NOREEN, P. BREWER and R. GARRISON, *Managerial Accounting for Managers*, p. 280.
[20] L. FELIX, “Financial statements, Analysis and Reporting”, ‹https://link.springer.com›, consulted on April 23, 2023.

is financing its operations through debt versus wholly owned funds. More specifically, it reflects the ability of shareholder equity to cover all outstanding debts in the event of a business downturn[21].

Table 8 Debt/Equity Ratio

Year	2021	2020
a) Total Liabilities	804	813
b) Total Equity	147	197
Debt/Equity Ratio = (a)÷ (b)	5.4X	4x

Z Enterprise has a relatively high D/E ratio (this is often associated with high risk); it means that Z Enterprise has been aggressive in financing its operations and growth with debt instead of shares, therefore, creditors in case of insolvency or bankruptcy can take over and leave nothing to shareholders.

Debt ratios vary from one industry to another, but a Debt/Equity ratio of 2.5 -3.5 and a Debt/Asset ratio of 0.4 - 0.7 are considered acceptable.

3.4 Profitability Ratios

Profitability ratios assess a company's ability to earn profits from its sales or operations, balance sheet assets, or shareholders' equity. Profitability ratios indicate how efficiently a company generates profit and value for shareholders[22]. Profitability ratios are drawn primarily from the Income Statement and fall into two categories: Margin ratios and Return ratios.

1) <u>Margin Ratio</u>s - Margin ratios give insight, from several different angles, on a company's ability to turn sales into a profit, where:
   - ❖ <u>Gross profit rate</u> = Gross profit ÷ Net sales
   - ❖ <u>Net Income ratio</u> = Net Income ÷ Net sales
   - ❖ <u>Operating Expense ratio</u> = Operating Expenses ÷ Net sales

Figures displayed in Table-10 are collected from the Income Statement in Figure 02 - (Z Enterprise Income statement - indicative form).

[21] G. S. DEVENDRAKUMAR, "Role of equity: an instrument of economic development*", International journal of advances research in management and social sciences* 2015, V. 4, p. 62.
[22] Y. COULON, *Rational investing with ratios*, Palgrave, 2020, p.85-104.

Table 9 Profitability Ratios - Margin Ratios

Year	2021	2020
(a) Net Sales	1265	1340
(b) Gross Profit	855	906
(c) Income from operations	(19)	75
(d) Net Income (or Net Profit/Loss)	(50)	32
Gross Profit Margin = (b) ÷ (a)	67%	68%
Net Income Margin = (d) ÷ (a)	(3.95%)	2.38%
Operating Expense Margin = (c) ÷ (a)	(1.5%)	5.6%

A negative Net income means that the enterprise has incurred a loss, and not a profit, over a given accounting period. While an enterprise may have positive sales, its expenses (selling expenses, operation expenses, general and administrative expenses) and other costs will have exceeded the amount of money taken in as revenue or sales[23]. A closer look at table 10 shows that Z enterprise has a negative Net Profit margin equal (3.95%) for the year 2021, Z Enterprise is losing 3.95$ for every Dollar has collected during the year 2021, this a significant sign of financial distress and a step toward an urgent restructuring process.

2) Return ratios - are a subset of financial ratios that measure how effectively an investment is being managed[24].

- Return on Assets (ROA) refers to a financial return ratio that indicates how profitable an enterprise is in relation to its total assets. Corporate management, analysts, and investors can use ROA to determine how efficiently an enterprise uses its assets to generate a profit. The higher the ROA number, the better, as the company is able to earn more money with a smaller investment. Put simply, a higher ROA means more asset efficiency.

$$\text{ROA} = \frac{Net\ Income}{Average\ Total\ Assets}$$

- Return on Equity (ROE) is a return ratio that measures the return to the stakeholders. ROE is considered a gauge of an enterprise's profitability and how efficient it is in generating profits. It measures how well a company's management is using its equity from investors to generate profit.

$$\text{ROE} = \frac{Net\ Income}{Average\ Total\ Equity}$$

[23] M. FRIDSON and F. ALVAREZ, *Financial statement analysis: A Practitioner's Guide*, p. 128.
[24] M. RIST and A. J. PIZZICA, *Financial ratios for executives: how to assess company strength, Fix problems, and Make better decisions*, Apress, 1st ed., 2014, p. 112.

Table 10&11 Profitability Ratios - Return Ratios

Year	2021	2020
(a) Net Income (or Net Profit/Loss)	(50)	32
(b) Average Total Assets	980	1010
(c) Average Total Equity	172	197
(d) Return on Assets (ROA) = (a) ÷ (b)	(0.051)	0.03
(e) Return on Equity (ROE) = (a) ÷ (c)	(0.29)	0.16

A negative return occurs when an enterprise experiences a financial loss or investors incur a loss in the value of their investments over a specific period of time. In other words, the enterprise loses money on either their business or their investment. Z Enterprise shows a negative Net Income associated with Negative ROA and ROE for the year 2021 in table 11, accordingly, Z Enterprise has not used its assets and equity in an efficient manner to generate profit.

4 RESTRUCTURING PROCESS OF ENTERPRISES

In this article / section 2 and section 3, we have defined the financial statements of an enterprise (Z Enterprise), explained their contents, and displayed the financial analysis process used to evaluate and measure an enterprise's financial performance and financial position. This is a fundamental process applicable to small and medium enterprises to determine whether an enterprise is economically viable and eligible for restructuring or leaning toward bankruptcy[25]. Restructuring is an action taken by an enterprise to significantly modify the financial and operational aspects of the company, usually when the business is under financial pressure, thus, Restructuring involves significant modification of debt, operations, or structure of a company as a way of limiting financial harm and improving the business[26]. Accordingly, the restructuring process which will be elaborated in this part of the article shall encompass the following:

1. Legal Aspect of restructuring in conjunction with the Lebanese law
2. Eligibility criteria to validate an enterprise restructuring process
3. Potential reasons of enterprise financial turmoil - an Input to restructuring plan
4. Restructuring rescue plan - Proposed remedial steps and recovery measures

[25] A. TAMOSIUNAS, "The Integrative management model for restructuring Small & medium sized enterprises (SME)", *Journal of advanced research in management* 2014, issue n°10, p. 81-91.
[26] A. DAWAS and T. KAMEEL, "Restructuring of distressed debtor: concept and personal scope in the UAE and Egyptian laws", *Kilaw journal* 2019, v. 7, p. 43.

4.1 Restructuring process in conjunction with Lebanese Law - Legal aspect and formal procedural steps

The Lebanese legislator drafted a project of law in 2018, aiming to avoid bankruptcy of traders by “safeguarding and restructuring enterprises with financial problems[27]”. By virtue of it, the creditors (obligatory) and the debtors (traders-optionally) may claim before the tribunal of first instance wherever the headquarters are located, for restructuring once the debtor is in a situation of payment cessation (shall be clarified by the legislator because the concept of restructuring doesn’t match with cessation of payment) or about to stop paying the debts. Failure to remedy the situation will leave him no option but to ask for the tribunal expertise.

A number of documents should be delivered by the person who initiates the process to help the tribunal make its decision to accept or reject the request of restructuring. If the debtor is the petitioner, he shall submit the following documents:

- The enterprise balance sheets for the last 2 or 3 years where the current and non-current assets, and the amount of current and non-current liabilities are clearly recorded.
- A list of his creditors, their names, residence, the amount alleged by each, guarantees if they exist.
- The enterprise financial statements for the last 2 or 3 years associated with ratio analysis and interpretation of figures (Liquidity ratios, Asset ratios, debt and profitability ratios), approved by the ministry of finance that clearly show the enterprise financial situation and performance.
- The obligatory and organized Commercial books dated two years before the cessation of payment or from the date of the commencement of his commercial activity.
- Proof of registration in the commercial register (if he is already registered) and a detailed statement concerning his commercial activity.
- Detailed report stating the reasons for both his restructuring request and for his financial problems with proof of his capacity to run his business as required by the law.

If the creditor is the plaintiff, he shall submit the following documents:

- Nature and value of his request which must not exceed a limit fixed by the competent authorities.
- Documents that prove the debtor failed to pay his debts 20 days after being served notice to pay.

[27] A decree n° 2805 issued by the government on the 27th march 2018 and transmitted to the parliament who hasn’t adopted it yet.

- Proof of payment of a fixed lump sum fee decreed by the ministry council based on the initiative of both the ministries of justice and finance, including the fees and expenses paid by the agent.

In this case, the debtor may appeal the decision of payment cessation and present all the documents that refute or disprove the creditors' allegations.

Based on the documents, the tribunal will make sure, that the plaintiff/petitioner is capable of adjusting the enterprise situation in order to accept the request of restructuring. For instance, the tribunal may perform an expeditious screening of the financial statements and decide on eligibility for restructuring or liquidation based on the following[28] :

The tribunal may check the debt ratio to comparing total liabilities to total assets in the balance sheet, if found less than 1 as elaborated in case of Z enterprise section 3.3.1 - table 8, the enterprise might at this stage be considered economically viable and subject to restructuring. Otherwise, if the debt ratio exceeds 1 excessively, the process of restructuring could not be feasible[29].

- The tribunal might also check on the enterprise profitability for the past 2 or 3 years; the Net Income recorded on the Income statement along with the profitability ratios as computed in section 3.4 - table 10 and table 11, will be used as indicators on eligibility for restructuring or liquidation.
- The tribunal might check on the enterprise cash and cash equivalents along with the retained earnings and cash flow records for the last 2 or 3 years, and accordingly decide on eligibility for restructuring or tend toward liquidation.
- The tribunal shall check lawsuits filed against the enterprise (contract dispute, accusations of fraud, employment matters, etc.). If the enterprise issued for damages by internal and external customers, restructuring will be difficult.

In light of the above, and by virtue of the tribunal's decision to start the process of restructuring, an agent will be nominated along with a judge to supervise the agent's acts. The nominated agent may replace the debtor in running his business or may act as a supervisor.

[28] S. MAYR (S.) and D. LIXL, "Restructuring in SMEs- A multiple case study analysis", *Journal of small business strategy* 2019, V. 29, n°1, p. 88.

[29] Those steps are not mentioned by the project of law but suggested by the author to be put into the tribunal and expert or agent's hands, the appropriate metrics to assess the operational and financial situation of a company in order to make an accurate decision.

4.2 Criteria to validate an enterprise restructuring process

It is the agent or practitioner’s task to review the multiple warning signs in addition to other fundamental inputs that might be indispensable, and proceed accordingly on whether the enterprise is eligible for restructuring or on the verge of liquidation[30].

The agent shall perform the following:

1. Gather and scrutinize the tribunal recommendations and preliminary decision.
2. Review the statement of claims and the creditors list.
3. Diligently screen all the financial and legal documents prepared by the debtor, in order to assess the situation of the enterprise.
4. Check on the enterprise’s expenses and revenues for the last 2 or 3 years recorded in the Income statement. For an enterprise to be profitable, all its expenses must be lower than its revenues. For this purpose, the profitability ratios offer insight, from various different angles, on a company's ability to turn sales into profit and offer several different ways to examine how well a company generates a return for its shareholders. A negative profitability margin along with a negative Return On Assets (ROA) and a negative Return On Equity, give thought to a poor business operation processes and incompetent management. For instance, and with reference to section 3.4, Z enterprise has recorded a Net profit in 2020 and a Net loss in 2021 (Refer to table 10 for ease of reference on profitability ratios - Margin ratios), Z enterprise is eligible for restructuring since it has accumulated profit for the years preceding 2021, thus adopting an adequate restructuring process inclusive effective remedial measures could foster its ability to generate a higher Net income in the forthcoming years. If an enterprise culminates an incremental loss for more than 2 or 3 consecutive years, restructuring would not feasible.
5. Check on the enterprise’s liquidity/debt position for the last 2 or 3 years. A very weak liquidity ratio such as current ratio or quick ratio, implies that this enterprise does not have the ability to pay-off its current liabilities with liquid assets in the short-term (refer to section 3.1 for further elaboration), hence this financial instability put the enterprise creditworthiness in jeopardy[31]. For instance, and with reference to section 3.1, Z enterprise has a low degree of liquidity and based on its current ratio, it has 0.8$ of current assets available to cover every 1$ of current liabilities (Table 4 in section 3.1). Z enterprise should enhance its liquidity degree to more than 1 for current ratio. An

[30] T. ZEIN, “Thoughts on companies rescue mechanisms in case of financial distress (Lebanese law project for enterprise restructuring in light of the French law)”, *BAU journal-legal studies* 2018, p. 9.

[31] J.-B. MAVRICK, “Strategies used to reduce a company’s debt-to-capital ratio”, ‹https://www.investopedia.com/ask/answers/040715›, consulted on May 20, 2023.

enterprise is considered in a dire liquidity position if its current ratio is usually less than 0.6, or if the enterprise liquidity ratios are very low compare to the industry average liquidity ratios.

6. Examine the debt position of an enterprise by computing debt ratio, as it is an utmost important indicator of an enterprise financial status[32]. A high debt ratio is often considered to be "highly leveraged", implying greater financial risk and more difficulty in borrowing money. The debt ratios measure the company's risk and likelihood of default, as high debt ratios are indicators of poor cash flow and inability to pay debts, and this is manifested as debts are growing faster than cash inflows. For instance, and with reference to section 3.3, Z enterprise has an average Debt/Assets ratio = 0.82 and an average Debt/Equity ratio = 4.7×, this means that Z enterprise has more assets than liabilities and has 4.7$ of debt for every dollar of equity, thus, Z enterprise relies on debts to finance its assets not on equity[33]. Restructuring of Z Enterprise operations to increase profits and decrease expenses along with raising capital and other financial procedures and rough decisions (will be displayed in the forthcoming sections) will be helpful to adjust debt ratios to reach acceptable range, and avoid imminent insolvency or bankruptcy. Moreover, when using the Debt ratios or any other ratio to analyze the financial status of an enterprise, the agent will consider the industry in which the enterprise operates, a ratio value that's common in one industry might be a red flag in another.
7. Check on the enterprise's accounts receivable and Inventory recorded on the balance sheet, and meticulously examine its associated ratios. A weak accounts receivable turnover ratio, implies inefficiency in collecting account receivables or a bad credit policy[34]. Furthermore, a weak inventory turnover ratio implies a shortfall in operations; sales, expected profit and return on investment (ROI) will be adversely affected as excessive inventory can tie-up a significant amount of money and occupy costly warehouse space. Low receivables and low inventory turnover will extend the operation cycle and diminish the cash inflow (refer to section 3.2 for further elaboration); a warning sign of a troubled enterprise. For instance, Z enterprise has recorded low accounts receivable turnover ratio (6×) and low inventory turnover ratio (3.15×) as computed in

[32] C. M. KOPP, "Debt Restructuring", ‹https://www.investopedia.com/terms/d/debtrestructuring.Asp›, consulted on January 28, 2023.
[33] A more effective step because debts are cheaper than equity.
[34] C-B. MURPHY, "Receivables turnover ratio defined: formula, importance, examples, limitations", ‹https://Investopedia.com/terms/r/receivableturnoverratio.asp›, consulted on March 3, 2023.

table 6 and table 7 in section 3.2, and accordingly Z enterprise needs an urgent and effective restructuring process to substantially improve its accounts receivable and inventory turnovers. Boosting accounting receivable turnover and inventory turnover shall be elaborated in the forthcoming section.

8. As previously mentioned, the restructuring practitioner may also act as an enterprise's agent. His role may comprise of:
    - Providing advising directors
    - Assisting the enterprise in preparing a restructuring plan
    - Ensuring that restructuring is feasible, and the enterprise is able to discharge the obligations created by the plan when needed.
    - Performing other duties including giving consent on transactions or dealings outside the ordinary course of business and resolving disputes over the amount of a creditor's debt or claim cited in the proposed plan.

In addition to the above, the agent shall diligently screen the enterprise's financial statements for the past 2 or 3 years. In particular, the balance sheet, cash flow statement, and annual reports should be examined to determine future short and long-term investment status. In addition to how efficient cash is utilized, the cash available and the expected cash inflow during the forthcoming months or accounting periods; he can then evaluate how the enterprise in financially tending as cash flow is crucial for an enterprise; most businesses fail because they lack cash reserves[35]. If the enterprise has negative cash flow and no cash reserves, and it is not in an expansion or growing phase, it is at risk of defaulting on its debts and current expenses and may need to take out additional loans. Negative figures protracted on the Cash Flow statement for more than 2 or 3 accounting periods is a warning sign of a troubled enterprise and may hastened its demise. Therefore, restructuring is essential to remedy the situation and improve cash inflow.

Once the agent has accomplished his duties, the supervisory judge shall hold a hearing to determine whether the restructuring procedure is feasible. A decision to pursue the process should be followed by the drafting or preparing of a restructuring plan, by the debtor or the agent, which should be presented to the supervisory judge.

[35] B. BEERS, "Business legal expense insurance- LEI", ‹https://www.investopedia.com/terms/b/business-legal-expense-insurance.asp›, consulted on April 2, 2023.

4.3 Potential reasons for enterprise financial turmoil - an Input to restructuring plan

It is substantial to Detect, investigate and summarize the causes of enterprises' failure or business financial distress in order to prepare an appropriate and effective restructuring plan. A wide range of causes exists, we will list here-below some of endogenous and exogenous ones.

- <u>Weak Management and inadequate knowledge</u>

  Lack of planning and poor management can lead to hasty decisions and business failure. For example, an enterprise management might spend time and money developing a product that might be useful, however is not financially viable from a business standpoint. Lack of education, communication, required skills, and experience in finance and management can increase the likelihood of poor decisions. This can be reflected on the Income statement and cash flow statement; where Net Sales decline and operating expenses increase, thus the enterprise will incur Net Losses and cash flow will diminish.
- <u>Market Conditions and Market Demand</u>

  Factors such as government policy, speculation and expectation, plus supply and demand, can influence market trends for the better or for the worse. For instance, Supply and demand for products, services, currencies, and other investments creates a push-pull dynamic in prices, therefore, if supply increases beyond current demand, prices will fall and protracted Net Income will diminish, plus retained earnings will substantially decrease and subsequently cash flow will dwindle[36].
- <u>Financing by Debt</u>

  The most common form of debt financing are loan and sales of bonds. Debts are collected to finance enterprises operations to meet its business objectives[37]. If a business is struggling, its operations would not be able to generate the anticipated Income / profit and enterprise will rely on debt to secure cash-flow to keep them afloat, therefore, Debts will increase significantly which make more difficult for an enterprise to be profitable. The computation and interpretation of Debt ratios in (clause 3.3) herein this article indicates the financial "Leverage" of an enterprise and the impact of the debts on its viability and sustainability. For a mature enterprise such as Z Enterprise, a high Debt ratio can be a sign of trouble that the firm will not be able to service its debts and can eventually lead to a

[36] G. HAMEL, "The future of management", ‹https://thelatestbook.com/download/4677785›, consulted on July 28, 2023.

[37] J. CHEN, "Default: what is a default?", <https://www.investopedia.com/terms/d/default2.asp>, consulted on June 30, 2023.

credit event such as default. Debt ratios should be considered relative to a company's industry and growth stage. Debt financing can be riskier if the enterprise is not profitable as there will be loan pressure from lenders. For enterprises in distress, the amount of debt-related payments (and other payments related to contractual obligations like pensions and leases) is too high relative to the operating cash flows of the firm.

❖ Ineffective business processes - Poor Account Receivables Management

Poor accounts receivables collections would also lead to a slowdown in cash flow[38]. A relatively low account receivable ratio implies that the enterprise has customers that take a long time to pay or do not pay at all, and therefore the cash flow will suffer (clause 3.2.1). Current and quick ratios in addition to the computation of the account receivable turnover ratio indicates how efficient the enterprise is regarding collecting their receivables, and therefore maintaining an acceptable short-term cash inflow.

❖ Ineffective business processes - Poor Inventory Management

Overstocking, deficiencies in the product line or marketing strategies etc…are signs of Ineffective inventory management that generate a low Inventory turnover ratio[39]. Stock obsolescence, poor cash flow and high carrying costs are some business problems that arise when Inventory turnover rate is low.

❖ Inappropriate business decision - Poor Investment

Enterprises often purchase equipment, properties and other assets to boost their operations and grow their business. The purpose of buying assets is to generate more revenue through their use and subsequently enhance their profit margins and ratios. However, bad investments in non-productive or inefficient assets can reduce enterprise cash flow; the enterprise is spending cash to buy the assets and they do not generate the anticipated cash inflow in return. Profitability margins and ratios in addition to the financial statements figures, indicate in case of poor Investments, a shortfall in revenues, income and cash flows.

❖ High Overhead and Operating expenses

When Overhead and Operating expenses outweigh the enterprise gross Income (as in Figure 02 - Z company Income statement / year 2021), the enterprise will incur Net losses.

[38] Ch. ADUSEI, "Accounts receivables management: insight and challenges", *International journal of finance & banking studies* 2017, (Istanbul) v. 6, p. 101-112.
[39] J-C. PATIN, "Impact of total asset impact on Equity returns: Dynamic panel data analyses", *Journal of accounting, business& management* 2020, v. 27, p. 19.

Overhead and operating expenses are crucial to the viability of an enterprise, hence keeping a strict control on those expenses is essential to prevent failure of business[40].

- Litigation filed against the enterprise

  Publicized disputes can tarnish a company's reputation. Contract disputes, data breach, false advertising and accusations of fraud can force a company to put business on hold. Litigation can ultimately decline a company's value, drive down sales, drain on finances or even cause a business to fold.

4.4 Restructuring rescue plan - Proposed remedial steps and recovery measures

Restructuring plan may be used by Enterprises facing financial difficulties that are capable of being rescued to avoid imminent insolvency. A Restructuring Plan creates a mechanism to re-organize enterprise operations, ratify agreement between the enterprise and its creditors and provide sustainable platform that enables an enterprise to restructure its balance sheet and hence release working capital into the business to fund future operations, clear financial issues and reposition the enterprise in a new more efficient manner[41].

A study of the reasons as mentioned above in section (4.3), facilitates the restructuring process which consists of eliminating or mitigating the causes of the enterprise financial turmoil. Accordingly, the restructuring plan should contain relevant remedial steps and recovery measures along with the projected financial statement data, and with the objective of promoting efficiency and restoring enterprise growth.

Referring to the Lebanese project of law, the plan drafted either by the agent or the debtor, 30 days’ maximum from the supervisory judge decision, shall include but not limited the following:

1. Definition and description of remedial processes and recovery measures that are substantial for the restoration of an enterprise. A business can restructure in many different ways. Each process if properly implemented, will enable the enterprise to continue operating and endure in the foreseeable future.
2. Business plan that shows the volume of business activity and the projected sales, income, costs and expected expenses in case the restructuring plan is implemented.
3. A report prepared by the agent stating the reasons for the necessity of implementing the plan, as well as the possibility of its success and verification that the conditions stipulated in the law are fulfilled.

[40] Ch. ADUSEI, “Accounts receivables management: insight and challenges”, *International journal of finance & banking studies* 2017, (Istanbul) v. 6, p. 101-112.
[41] S. MAYR and D. LIXL, “Restructuring in SMEs- A multiple case study analysis”, p. 90.

4. A final list of claims and the names of the creditors, specifying the category to which each creditor belongs. A table describing the proposed transaction for each category of creditors, specifying the terms of debts repayment, deadlines, and applicable guarantees or swaps, if any.
5. The person who will be responsible for implementing the plan, and this person may be either the agent or the debtor[42].

4.4.1 *Financial Restructuring - A recovery Processes*

Financial restructuring is necessary when the amount of debt and obligations on the balance sheet are no longer appropriate for the enterprise value of the firm. When this occurs, a solution is required to *"right-size"* the balance sheet so the company can resume its operations[43].

A fundamental process of financial restructuring is the Debt Restructuring. This step improves the company's chances of paying back its obligations and staying in business. Some of the usual content of debt restructurings are the following:

- Rescheduling of payments: (e.g., deferral of certain repayment installments, extension of debt maturity). A rescheduling of payments constitutes a novation of the former debts for the creditors that participate in the restructuring agreement. Therefore, debt with new characteristics will substitute the old debt.
- Debt for Equity Swap: It is a refinancing deal in which a debt holder gets an equity position (part ownership) in the business in exchange for the cancellation of the debt such as bonds. The swap is generally done to help a struggling company continue to operate.
- Alteration of interest rates: Debt with high interest rates is one of the common causes of financial distress. The reduction of interest rate whether fixed or variable requires a novation of the debtor's original obligations.
- Factoring: when the company resorts to a third party (factor) to sell its accounts receivables and consequently increase the cash flow, a major step for debt restructuring[44].

These recovery measures will gain the enterprise a financial flexibility and stability in the short-term to continue its operations, make their debt load more manageable, lessen the degree of leverage and improve significantly the enterprise debt ratios.

[42] Those steps are required by the project of law and the remaining ones issued from practice. Every industry has its own needs and characteristics that is why different measures are usually taken to remedy the situation. The Author suggested many steps from which to choose from in order to draft a plan of restructuring.
[43] C.M. KOPP, "Debt Restructuring", ‹https://www.investopedia.com/terms/d/debtrestructuring.Asp›, consulted on January 28, 2023.
[44] N. AL SHARFI, *Factoring contract (comparative study)*, Zein publisher, 2013, p. 58.

4.4.2 *Operational Restructuring - A remedial processes*

Operational restructuring is a process which aims to make a company and its business model profitable by identifying which areas of the company are underperforming and how they can improve, it explores how the business can return to profitability by improving its product and service offering, raising the employees' level of competence and how it runs on a day-to-day basis[45].

Operational restructuring in the company is needed, among other things due to nonconforming products or services, changes in the customer needs, poor responsiveness of the company to technological development and obsolete means of production (machinery and equipment), inadequate knowledge and lack of specific skills of employees, ineffective business processes, etc. Positive result of enterprise restructuring is usually a result of coordinated activities in operational and financial restructuring. The restructuring plan may comprise various operational recovery processes:

1. Management restructuring: Management plays a crucial role in enterprise success, employees at managerial position are responsible for ensuring optimal outcomes, profits, lucrative investment strategies, optimization of resources and functioning and development of the enterprise entire systems[46]. Therefore, they are held accountable, each of them within the scope of responsibility. Hence it is sometimes necessary to replace the existing management who unable to introduce necessary changes with a more competent one. The change of management is an important step towards the recovery, since it can reestablish the trust of stakeholders and can bring new skills and motivation to achieve organizational change. Regardless of the type of restructuring, the new management primarily has the obligation to:
    - Define and adhere to restructuring principles (legality, objectivity, cooperation, patience, transparency, prevention).
    - Objectively assess the existing state and problems in the former management system, clearly set and explain objectives.
    - Clearly define and explain the role of all participants in the restructuring (owners, employees, representatives of workers, social community, customers, partners, etc.)
    - Consult with representatives of workers (works councils, unions) and, if possible, ensure their cooperation and support.

[45] N. KIRK, "What is operational restructuring?", ‹https://gateleyplc.com/insight/guides/organisational-and-operational-restructuring/›, consulted on February 12, 2023.
[46] S. MAYR and D. LIXL, "Restructuring in SMEs- A multiple case study analysis", p. 92.

- ❖ Provide necessary resources, particularly financial means.
- ❖ Determine the price of restructuring.
- ❖ Select consultants, if planned to use their services.

2. Cost restructuring: enterprises use cost restructuring as a recovery measure. This involves restructuring department budgets, enacting furloughs or layoffs, job enlargement, and other cost-saving and cost-cutting measures concise as follows:
    - Downsizing of workforce: it is a cost-cutting strategy; its main goal is to reduce operating costs. Advocates of downsizing suggest that there may be cost reduction because of lower overhead, less bureaucracy, faster decision making, smoother communications, greater entrepreneurship, and increases in productivity[47]. Accordingly, it is important for enterprises to monitor these variables to assess the extent to which the goal of cost reduction has been achieved. There are several tools for downsizing presented as follows:
        - ➢ Early retirement: This strategy is often used early in a cost-cutting process because it is relatively gentle and employees are not forced to leave the enterprise against their will. This is seen as a major advantage because older employees with long tenure are frequently more expensive to the organization.
        - ➢ Outsourcing: it is generally understood as the practice of contracting with another enterprise for delivery of certain services or products, typically at lower cost and increased quality. A number of specialized management services may be outsourced, for example, payroll, accounting, utilities, and so on. The advantage of outsourcing is that it can produce early cost savings through cheaper access to specialized services.
        - ➢ Temporary employees: the use of temporary versus permanent employees has some cost saving advantages. Temporary employees can be readily laid off when their services are not needed, they usually have lower salaries and markedly lower benefits, and they are not employed long enough to build relationships or ties in the enterprise.
        - ➢ Employees layoff: The need to cut back on costs can arise from the fact that the enterprise is not making enough profits to cover its expenses or because it needs substantial extra cash to address paying off debt. Layoffs

[47] K. WHELAN, "Advanced Macroeconomics. Growth accounting", ‹https://www.karlwhelan.com/Macro2/slides-8.pdf›, consulted on June 10, 2023.

also occur when a company needs to eliminate some superfluous positions in order to make its operations more efficient.

- Cut back on the extras: the enterprise new management can freeze additional hiring, reduce or remove bonuses and raises, and eliminate unnecessary travel as an avenue of saving expenses

- Divestment: it is a type of restructuring where enterprises close branch locations, departments or other business units, production line or any operating division, due to revised needs or profitability expectations[48]. Divestment also involves an enterprise selling off a portion of its unproductive and obsolete assets such as real-estate or equipment, to free up and foster enterprise capitals and cash flow and focus on primary operations and expertise.
- Mergers and Acquisitions: Mergers and acquisitions refer to a type of restructuring in business where an enterprise consolidates branch locations or appoints one person as the head of multiple departments[49]. The primary objective of cost restructuring and other restructuring types and strategies in a restructuring plan, is to manage the surplus of Overheads and excess operating expenses and alleviate their impact on the enterprise financial performance. These restructuring processes if implemented as planned will improve the figures recorded on the enterprise projected financial statements and subsequently enterprises liquidity and debt position will change significantly.

3. Enhance enterprise profitability; In terms of business growth, profit maximization should always be one of enterprise main goals[50]. There are various ways to do this, some of which are listed below.
    - Increase prices: Instead of reducing prices, an enterprise could actually benefit from increasing its prices. Even a slight increase in price of 1-5% can drastically improve enterprise profits. Actually, even taking into consideration that an enterprise might lose some of its sales volume, there will be a positive impact on profit. This means it will be making more money per sale, with fewer sales overall and less operations efforts and expenses.

[48] A. GANTI, “Divestment: definition, meaning, purpose, types and reasons”, ‹https://www.investopedia.com/terms/d/divestment.asp›, consulted on January 20, 2023.
[49] A. MISSONIER, S. MISSONIER, F. LASCH and A-S. THELISSON, « Comprendre un processus de fusion sous le prisme de la pensée complexe », *Revue française de gestion* 2021, n° 297, p. 100.
[50] A. DAVIDSON and M. SIMONETTO, “Pricing strategy and execution: an overlooked way to increase revenues and profits, *Strategy and Leadership, Emerald publishing 2005,* V. 33, p. 25-33.

- Increase the number of customers; by building a customer base the enterprise will increase sales, add new customers; if they are satisfied it will result in repeat business. Reaching out to new customers and markets usually requires some sort of targeted marketing, from handing out flyers in the street, to TV advertisements and digital marketing.
- Provide outstanding customer service; satisfying the needs of the customer by providing high quality service and assistance, is the means to achieve profit, growth and stability[51]. Therefore, the restructuring plan might include some strategies to achieve customer service excellence. "PACT" model or "RATER" model could be good strategy to improve quality customer service and foster customer loyalty to the enterprise. Customer satisfaction leads to growth in revenue through repeat purchases and referrals, and to a decrease in costs as a result.

4.4.3 Eliminating ineffective business processes

The elimination of the ones that cause poor accounts receivables and inventory turnovers, is an indispensable process in the restructuring plan to improve the enterprises' financial situation.

Optimizing accounts receivable processes might seem daunting at the outset. However, by taking a methodical approach to the situation in the restructuring plan, the enterprise will encounter a considerable improvement. The following two business activities, when properly optimized, will significantly improve the overall functioning of an enterprise accounts receivable process and, in return, produce other benefits for the business as a whole.

- Establish an effective billing process and systemize invoicing and payment the billing and invoicing of customers must be accurate and sent in a timely manner. One way to improve billing and invoicing is by automating as it ensures speedy delivery and payment.
- Develop new strategies to optimize collection process: Collection efforts should be consistent and methodical. A clearly defined process for negotiating payment plans should be established to ensure that it dovetails with the company's overall objectives. Optimization techniques to improve collection may include but are not limited to; Promoting automated messages such as emails, video calls, enhancing the communication skills of the enterprise accountant management team or simply adjusting the enterprise's terms for late payers so they have to pay upfront before services are delivered, thus avoiding any kind of bad debt.

[51] L. BENSTON, "Gaughan gambles on looser slots, satisfying customers is most important", ‹*Newspaper Las Vegas Sun* 2010, ‹https://www.proquest.com/newspapers/gaughan-gambles-on-looser-slots/docview/578498895/se-2?accountid=27870›, consulted on 20 March, 2023.

Furthermore, managing enterprise inventory efficiently is crucial, the restructuring plan may include a few simple yet effective processes, tools and techniques in order to organize stock, ensure warehouse efficiency, improve inventory management and increase inventory turnover ratio[52].

- Monitor demand closely to avoid stock-outs; the new management should track sales data to identify products that have shown consistent growth in demand, and increase procurement accordingly. The use of forecasting models will be helpful to predict demand in upcoming months, thus maintain more safety stock for products with higher expected demand.
- Audit enterprise inventory stock regularly; maintaining accurate inventory by auditing the data regularly ensures inventory optimization.
- Invest in an inventory management system; the enterprise needs to maintain accurate records, process customer orders, create and send invoices, manage suppliers, and much more. Doing all of this manually is not just time-consuming but also prone to data entry errors. Therefore, the enterprise should use inventory management software to automate these processes and reduce the chance of human error. An inventory manager can automatically track existing inventory levels, raise purchase invoices for new and repeat orders, categorize products into multiple batches, create real-time reports, and monitor stock movement. This is also helpful to set automatic reorder points avoid stock-outs.

Establishing a coherent and sustainable accounts receivable and inventory management system and eliminating ineffective business processes and strategies, means the business is turning its sales into cash, which frees up capital for growth, adds liquidity, can help reduce debt and lower costs, and make the business more competitive.

In light of the above, a restructuring plan is a robust plan that comprises an integrated restructuring measures, processes, strategies and techniques. Managers, employees, and any person in charge of drafting a restructuring plan for an enterprise, should be familiarized three key financial statements: the balance sheet, income statement, and cash flow statement. An adequate knowledge and understanding of those key financial statements and how to analyze them, will give clearer picture of what business is spending and earning, and lead to productive conversations with other decision-makers about planning, budgeting and efficiencies along with selecting the most effective and beneficial restructuring strategies.

[52] K. DEMETER, K. and Z. MATYUSZ, "The Impact of Lean Practices on Inventory Turnover", *International Journal of Production Economics* 2011, p. 133-154.

4.4.4 The implementation of the restructuring-plan

A certain equality should be ensured, by the plan, among creditors belonging to the same categories, which should be implemented within 5 years' maximum. In addition to the supervisory judge approval, the majority of the creditors (association of creditors presided by the supervisory judge) should accept the clauses of the plan and ensure that there is no infringement on their rights. The creditors who reject the implementation of the plan can appeal the decision of the supervisory judge of adopting the plan of restructuring after making sure that all the required conditions have been overseen either by the agent or the debtor. The judge may consult independent experts before rendering his decision. The decision to approve the plan should comply with all publication requirements such as being published in the commercial register.

After implementing the plan and finalizing the necessary remedial processes and measures, the person in charge (debtor or agent) should prepare an annual report which describes the progress resulted and deposit it before the court to be at the creditors' disposal. The latter may ask for any additional information for clarification.

The agent or the debtor should inform the supervisory judge of finalizing the execution of the various stages and operations of restructuring; for this a certificate or a receipt is required to prove the full implementation. Everyone involved may object in writing the non-compliance of the plan clauses. In this case, the tribunal may accept the objection and start the liquidation process or reject the objection and approve the full implementation.

A decision approving the full implementation ensures the survival of an economic entity (company) and gives a second chance for the investor (good faith) to function in an appropriate way without being overloaded with debts and mismanaged by incompetent managers.

5 CONCLUSION

A financial statement analysis is recommended to reveal the real financial health of an enterprise. An indication of an economic viability is necessary to prevail the process of restructuring over insolvency. As shown in this case study, many indicators should be observed and analyzed by the experts to deliver their reports to the tribunal. Based on this report, the tribunal will then render a decision to restructure or to liquidate the company. For example, different ratios shall show the capacity of the company to generate revenue and liquidity from its assets or Accounts receivables for better debt management. The financial study of Z Enterprise showed in 2021 a halt in growth and a higher level of losses notwithstanding the existence of fixed assets which can be an indicator of possibly saving the company. However, If the Net Loss extends for more than two consecutive years (continue to the year 2022) it wouldn't be easy or convenient to proceed with the act of restructuring.

The study showed that even if the enterprise is in financial turmoil (in a state of cessation of payment) it will not necessarily face bankruptcy. The latter is a harsh process for the trader who maybe a victim of a situation beyond his control and will deter new investors.

The alternative is to help the trader through operational or/and debt restructuring, however it will depend on the financial state of the enterprise. As we highlighted in the article, restructuring is a way of limiting financial harm and improving the business through modifying the financial and operational aspects of the company; supervised by a competent court. Hence, it gives a chance for the enterprise to pursue its activity and hope for the investor of future profits. The process of restructuring also has an indirect impact on the investment at national level, a multitude of bankrupt companies impacts the national economy and discourages investors. In Lebanon, we lack laws that provide for rescuing and financial assistance of ailing enterprises, on the contrary to most Arab[53] and European countries which have designed specific regulations for such cases. However, the difference between them is that most of the Arab countries have added the process of restructuring to the existing bankruptcy law and the European countries have replaced the bankruptcy act with the restructuring one; this is the intention of the Lebanese legislator, which is yet to be implemented. Moreover, the act of restructuring requires financial support most of the time, this is not easily ensured by the court as stated by the Lebanese project of law; this is normally the banks job. Therefore, a law that supports small and medium enterprises must be enacted and implemented.

Are the Lebanese banks currently able to support those enterprises?

In Lebanon, the legislator should not adopt the same regulations as France rather he should take into consideration the special circumstances occurring in Lebanon and adapt accordingly. He has also to take into consideration the absence of integrating financial support and specialized courts to nominate professionals to identify the possibility of restructuring.

[53]Egyptian and Emirates laws integrated the concept of restructuring of enterprises in turmoil.

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