Liturimex viešbučiai, Lithuania

- Type of restructuring:
  Internal restructuring
- Employees before restructuring:
  10-49
- Employees after restructuring:
  0-9
- Nace/Sector:
  Hotel / restaurants
- Country:
  Lithuania
- Date:
  16/01/2012

Abstract

A Lithuanian company operating in hotels and catering ran into trouble when having to guarantee bank loans, outstanding money and the economic crisis coincided. A court appointed a new administrator to try and save the company. All employees lost their jobs but many were subsequently rehired.

Organisational profile

Liturimex viešbučiai was established in 1996 as private limited company in the hospitality sector. It owns a hotel and a guest house in the resort of Druskininkai. The company is now a 'restructuring joint stock company' because of a court decision. This means it is restricted in transferring the assets and has an obligation to pay off all approved liabilities, but in other actions and transfers may act as other joint stock companies. After the company fulfils its legal obligations and the restructuring period is over, it can claim the status of a joint stock company. The company is based in Lithuania's capital, Vilnius.

The main activity of Company is the hospitality business (hotel, including provision of conference services, and restaurant). According to the approved restructuring plan, the company does not intend to change its business profile.

The company has two buildings in Druskininkai – the Regina hotel which has 40 rooms, a restaurant and two conference halls, and a guest house with 11 rooms. Both are in the centre of the resort close to the main attractions such as an aqua park, biking, walk and riding paths, a forest park, spa, and snow skiing/snowboarding arena. The three-star hotel was the first in the town to meet European standards for hotels and kept this status until 2004.

Druskininkai is one of Lithuania's four main resorts, about 130 km from Vilnius and very close to the Polish and Belorussian borders. The resort is a spa town, offering mineral baths, mud and climate therapies. It is becoming an international all-year round resort: the share of foreign tourists is increasing every year, that is, from 27% in 2007 to 41% in 2011. However the share of local and national tourists has decreased.

This trend is reflected in the register of the hotel: in 2009, about half the guests were foreign tourists whereas in 2011 this share had risen to two thirds. The company has an international presence, with sales to foreign tourists counting as exports. The nationality of the hotel guests is also changing. During 2009–2011 there was a significant increase in the number of tourists from Poland, Russia, Belorussia, with a slow increase in the number of tourists from Germany and the UK while the number of tourists from Latvia and Israel remained almost the same. Indeed, the tourists from Poland, Russia, and Belorussia helped to balance out the effect of the financial crisis, which was at its peak in the hotel business in 2010. About three quarters of Lithuanians staying at the hotel come from Vilnius and Kaunas (the country's second city) while those living close to Druskininkai are very rare.

The company is a part of a larger organisation, of other hospitality sector companies, such as a travel agency, car rental business and guest house.

The company's main shareholder, before restructuring, was Rimvydas Aniulis who, together with a manager, was involved in running the business on a daily basis. During the restructuring process he became a creditor, when the shares were sold to Liturimex grupė and to another person (who remains anonymous, by law). In January 2012, the main shareholders were:

1. private company Liturimex grupė (77.35% of theshares);
2. private company 'Liturimex'(9.4%)
3. private company SRTP (9%);
4. an anonymous person, not Rimvydas Aniulis,(4%)

The previous main shareholder still has some shares in other private companies – in 'Liturimex grupė' and 'Liturimex kelionių agentūra' (the travel agency) which is undergoing bankruptcy proceedings, but Liturimex viešbučiai is still operating and has good prospects for a successful exit from restructuring and for future development. It is run by a board of three people, chaired by Rimvydas Aniulis (now a creditor) and has enough power to influence the restructuring. It and the group of its indirectly related companies together comply with definition of SME (in terms of turnover, assets, number of employees, including share or managing rights in other companies) and had less than 100 employees before restructuring started. However, before restructuring, the companies were not legally seen as a group or holding: they were connected simply by having the same shareholder.

Business increased for Liturimex viešbučiai after 2001 with significant growth during 2006–2007. There was a drop in sales in 2008–2009 and although there was slow growth in sales in 2011 (LTA 2.1 million, about € 0.61 million), it was slightly more than forecast in the restructuring plan.

At the beginning of 2009 the company had 42 employees, but when it got into difficulties all of them had to be dismissed under a court-approved restructuring plan, although all were paid compensation, according to restructuring law. After that only three previous employees were rehired (the chief accountant, administrator in reception and one employee). A new manager was hired, however during restructuring the reception administrator and the employee were dismissed and in January of 2012 only the manager and accountant were employed in the company.

Before restructuring about 20% of employees had high or higher education and were able to speak two or more foreign languages, with the rest of the employees having secondary, professional or special education. About two thirds of employees were women. Almost all employees were local.

After restructuring, the management of the hotel and restaurant were taken over by an operator company, approved by the creditors board. This operating company has rehired about 60% of the previous employees. The qualifications and experience of the current employees are good and appropriate for the current activities.

Due to the low number of employees before restructuring there was no work council or trade union presence in the company. There were no special strategies for human resources, or corporate social responsibility. There was only a verbal commitment of being honest to all stakeholders.

Background to restructuring event

In 2004, the company decided to extend and modernise the hotel, and it applied for EU structural funds assistance (grant up to 50%). The applicant also put up some own finance, for which the company approached a bank for loan. The bank agreed to a loan, to be issued after the company signed the EU contract. The company went ahead with the modernisation, but after signing the EU contract the bank decided not to advance the cash, as had been agreed. Furthermore, it asked the company to pay a previous loan before its original deadline. This meant the company would have to complete the project by using its own resources – using all its working capital.

However, the company was also a guarantor of loans to the other related companies. When the economic crisis started in 2008, sales plummeted in all the companies which led to them having problems with repayment. This meant the company became responsible for a few loans, at a point when the occupancy rate in the hotel Regina was beginning to fall.

This difficult financial situation for the company was worsened by a 5% increase in VAT, to 21%. The company started to run out of working capital; its cash flow from sales decreased, which led to debts to creditors, employees, suppliers, the tax inspectorate and, crucially, the state social security fund. When the company failed to pay its social security contributions in time, all accounts of the Company was frozen and company's activities. Because a part of the Company's liabilities was overdue, creditors applied to the Court. Therefore the Company has no possibility to continue the main activities (related to hospitality business) and pay off to creditors, shareholders of the Company and related companies. According to the Restructuring Law of Lithuania creditors have initiated a restructuring case at the Court in 2009. This is a typical example of internal and formal (with proceedings in the Court) restructuring type.

Vilnius District Court ruled that the restructuring case for the company should proceed while the other related company (travel agency) should face bankruptcy proceedings. No action was taken on another related company, Liturimex grupė, which was operating successfully.

The external drivers of restructuring were:

1. the economic crisis in Europe (which affected foreigntourists) and in Lithuania (which discouraged national tourists);
2. inadequate regulation of banking sector and unfairbehaviour of banks;
3. suddenly increased taxation;
4. adverse affect of the actions of stateinstitutions.

Internal causes were:

1. the mismanagement of cash flows;
2. too high liabilities;
3. under-evaluation of possible risks.

The impact of external factors was deeper than that of the internal factors and couldn't be controlled. The changes in business environment (under-regulation of the banking sector, increasing taxes, actions or inaction of state institutions) affected the company not only directly, but indirectly too, as other people and companies facing some or all of the same problems could not use the company' services any more. The effect of the economic crisis is visible in the nationality of the guests: since 2009 the share of tourists from Poland, Russia and Belorussia, which had been little affected by the crisis, were increasing.

The internal causes could not be explained only by a lack of managerial ability. The owner and managers had long experience in hospitality, and the company had operated successfully for many years. Expanding too fast and over-extending business development is still very risky in Lithuania. Lack of the ability to plan long-term was the main internal cause of the restructuring, rather than lack of managerial capacities.

Restructuring processes

The company began its restructuring before it was formally ordered to do so by the court. As its financial difficulties mounted after 2008, the company's shareholders (the main shareholder and small shareholder) started to consider restructuring as possible option to save the company together with selling some shares to other investors. In order to make up for the lost bank loan two new shareholders (Liturimex and SRTP) came into the company. Legal advice was taken and in February 2009 shareholders agreed on restructuring if insolvency problems arose. They also considered inviting the participation of other financial institutions, but this option could not be realised due to later events.

However, the situation then worsened very suddenly in the other related companies and the company, as guarantor for their loans became responsible for paying their debts. The bank announced that it intended to take over all the businesses, including the company, using bankruptcy proceedings. At this point the shareholders decided to start restructuring proceedings immediately for the company and undergo bankruptcy proceedings with the other companies.

A written four-year plan for restructuring was prepared with the participation of the company's shareholders, board members, creditors, lawyers and consultants. It was submitted to the court in Vilnius for formal approval at the end of 2009.

A restructuring administrator was appointed. A company management body, with a general manager, was given the task of supervising the plan's implementation with mandatory accounting to an assembly of creditors. The court gave its final approval of the plan on 4 February 2010.

The plan's objectives were to:

1. repay all the creditors according toschedule;
2. save and continue the business;
3. avoid bankruptcy;
4. restore long-term solvency of the Company and its abilityto fulfil liabilities to creditor
5. save existing jobs;
6. reorganise the company, putting it back intoprofit;
7. restore and increase the value of thecompany and earn higher profit in future.
8. indicative duration of the restructuring plan was fouryears after its approval with the possibility to complete earlier if all debtsto creditors and liabilities were fulfilled before deadline.

In order to restore solvency the creditors' claims were approved, business was maintained, money owing to it was chased up, and some assets were sold. Although the plan foresees the company paying off its debts through business activities, it also allows for the company's debts to be paid, in the event of the plan failing, by selling the guest house.

Running the hotel and the restaurant were divided into the separate activities and transferred to an operating company in 2010. The restaurant operating contract lasts until 1 September of 2013, and the hotel operating contract, including the provision of conference services, finishes on 15 September of 2015. Restaurant and hotel operators will pay fixed amounts to the company every month and act on their own risk and at their own expense. The income goes towards paying off debts and other liabilities. The company still disposes the asset (based on reverse leasing contract with bank), used in the restaurant and hotel operation. It also runs the accommodation at the guest house (although reservations go through the hotel).

A special reverse leasing agreement was signed in 2010. This meant the hotel and restaurant buildings were sold to a bank and then leased back to the company. Income from this was used to pay creditors. Recovery could be realised more quickly by:

1. finding a purchaser for the estate;
2. refinancing;
3. attracting other financial institutions or strategicinvestor.

Finding an investor might be quite easy if the global economy stabilises because the company is still very attractive. It is in a favourable location (in the centre of resort and the resort is rapidly developing), has a well developed business, loyal clients, and a stable income. However, finding a financial institution might not be so easy, due to a tightening of requirements in the finance sector.

The payment of the debts in the restructuring plan is distributed (by law) according to categories of creditors:

1. first tier, employees;
2. second, tier, creditors with mortgaged debts and theState Social Security fund;
3. third tier, other creditors.

The debts are shared between:

1. a bank (59.03%);
2. shareholders (36.08%);
3. suppliers (3.29%);
4. State Social Security fund (1.58%);
5. employees (0.01%).

Debts to employees have been paid and the second tier is now being dealt with.

The payments to creditors were scheduled over the four years of restructuring:

1. year one, 54.07% of debts;
2. year two (18.45%);
3. year three (27.48%);
4. year four (0 %).

Although the plan envisages the debts paid off before year four, the duration of the plan was approved by the court, and the contract with the hotel and restaurant operators will still be running when the restructuring period ends on 1 September, 2013.

The plan meant that all 42 employees were dismissed. Only three were rehired, plus a new general manager. In 2012 the company had only two employees (manager and chief accountant). Because there was no work council or union representation there was no consultation during restructuring with any of the employees. However, some information and explanation were given to employees at meetings. Under the terms of restructuring law warning notices about the dismissals were sent to them. Generally they were given two months' notice, although parents with two or more children under 12, and people close to retirement got four months' notice. The new operators of the restaurant and hotel had to agree to hire at least 60% of the hotel's previous employees.

A fund for salaries of employees was established, and will be used until the end of 2013 (or until all debts are paid, whichever is earlier). The fund has a fixed annual growth. During the first year of restructuring it will grow by 15%, and then by 25% of its original amount every subsequent year. There is also an opportunity for bonuses for meeting sales targets.

The restructuring period can be counted from the date of shareholders' decision for restructuring (4 February 2009) or from date of decision of the court to start the restructuring case (11 November 2009). The final date would be 1 September 2013 or the date when all liabilities to creditors will be fulfilled, whichever is earlier. The final date of the restaurant operation (15 September 2015) has also to be taken into account, after which the company will be able to carry out all the business related to the hotel, restaurant and guest house.

In 2011 there were higher incomes than expected from the hotel, restaurant and accommodation at the guest house, which suggests that restructuring could finish earlier than planned. Nevertheless, the uncertain situation in the global economy still has to be taken into account, as well as in the company's European export markets (Poland, Germany and the UK).

Challenges and constraints of restructuring

The main challenges were:

1. dealing with the banks in court to try to avoid thebankruptcy proceedings;
2. getting court approval for restructuring;
3. finding operators for the hotel andrestaurant;
4. getting the operators to rehire at least 60% ofemployees;
5. saving the business.

The company needed a lot of legal assistance to withstand the bank's pressure and intimidation and to act fast against the bank in court proceedings by submitting a great deal of documentation.

The search for people to run the hotel and restaurant was a huge challenge due to the economic crisis, however, specialist consultants were used and favourable contracts were signed.

Restructuring advice and support

The company paid for the preparation of the restructuring plan and the restructuring process including the redundancy money, and fees for lawyers and consultants. The company and shareholders paid for the court costs, which were significant. No external financial or non-financial support was received either from state, municipal or other public funds or from private institutions such as banks or business associations. Moreover, the State Social Security Fund froze all the company's accounts and paralysed all activities which could have contributed to paying debts.

While planning the restructuring, and during the restructuring process, lawyers and consultants gave advice to shareholders, including the company board, and later to creditors too. These services were paid for by the shareholders; their costs were relatively low and effectiveness of such services could be assessed as very high.

The important role of the shareholders should also be stressed – they were actively involved in finding possible solutions. Their long-term experience in the hotel business, and knowledge of business diversification (such as the hotel travel agency and car rental) and membership of a business association helped them be realistic in:

1. evaluating the situation;
2. coming up with two possible solutions;
3. considering and planning restructuring.

The court proceedings were fair and helped to save the business, but also ensured its good prospects after the completion of restructuring. The case took a relatively short time to be decided, with the restructuring plan being implemented in 2010.

Lithuanian law does not take into account the need for SMEs to have financial support during restructuring, when the small cost of subsidising redundancy pay, or retraining, or helping employees to find new jobs would be welcome. People can apply for financial support or training at the Labour Exchange only after dismissal. This upset and frustrated the company's employees, whose financial situation was hit by the lengthy restructuring period, unpleasant dismissal procedure and uncertain future.

Outcomes of restructuring

The main outcome is that the business has been saved from bankruptcy and has good prospects. The first stage of restructuring is on course to be completed successfully.

Another outcome is the two contracts with the hotel and restaurant operators, which provide the company with a stable cash flow.

The employees' first reaction to the restructuring announcement was negative, especially in the case of employees, who had worked at the hotel for many years and had contributed to the family atmosphere by having close and friendly relations with guests who returned every year. Despite getting redundancy pay, many employees were upset by the company's difficult situation.

However there was a positive outcome in that about 60% of the employees were given jobs by the restaurant and hotel operators. Another 10%–15% of employees found similar jobs elsewhere in Druskininkai. Unfortunately, about 25%–30% of employees did not find a job in the resort and have emigrated.

Another outcome is the salaries fund, which has special terms for fixed annual growth, and a possibility of bonuses for achieving sales targets.

No human resource strategy is foreseen until after the restructuring process is completed.

Overall, restructuring has more positive outcomes than negative ones. The business is saved, the company is on its way to solving its debt problems, and some previous employees are still working in the same hotel, restaurant and guest house, and there are good prospects for future development and job creation.

Commentary

There are a number of important differences between restructuring in SMEs and restructuring in large organisations.

Large companies have more power in negotiating with banks or other creditors, have more managerial and planning capacities and experience, and therefore they make fewer and smaller mistakes. Large companies are also less sensitive to changes in the business environment, such as changes in taxation or the introduction of new legal requirements.

However, large companies could be affected more by the economic crisis due to higher total operating costs. Also, when larger companies downsize the effect on unemployment is higher. Sometimes a large company is the only significant employer in a small town.

Large companies depend less on public investments because they have their own resources to pay for new facilities. In the hotel's case there was no public information about the town's plans for investing in a huge spa complex. If the company had known about these, it would not have invested unnecessarily in such facilities itself. This information was kept secret by the municipality, but the situation has improved since 2007, because all public investment programmes have now to be published.

Large companies have more resources (managerial and financial) to plan restructuring and can call on additional external resources if needed. Therefore they can implement and manage restructuring better than SMEs. As a result, many larger companies are more able to adapt to a changing environment, for example, splitting a restructuring plan into a few stages or postponing some actions, and they have more flexibility to deal early with crises and to dismiss employees step by step. An SME usually has no external support, although the company did use paid external lawyers and, advisors. Large companies can also apply for financial support for retraining during the dismissal process.

Trade unions or work councils can play an important role in the restructuring of large companies. However, sometimes their intervention has negative effects due to groundless claims or the protraction of restructuring, which may lead to bankruptcy. Trade unions and work councils are much less common in SMEs.

In this case study, the absence of a trade union or works council does not appear to have damaged the employees' interests. However, their absence meant the company did not need to negotiate terms, allowing it instead immediately to begin restructuring when the situation became complicated. This enabled the company to save the business and a lot of jobs.

Employees were informed in proper time and in writing, the terms of dismissal complied with restructuring law, and all compensation was paid. The fixed annual salary fund was not required by law.

This company's experience demonstrated a need for advisory support. The company's use of legal and other consultants' advice was atypical for SMEs, but contributed greatly to successful restructuring. The respondent would advise the use of such services despite costs, which are relatively low.

This kind of support is needed because of weaknesses in the regulation of the banking sector, which enabled a bank to treat an SME unfairly with uneven contracting and negotiation power. Publically supported advisory services for SMEs in planning, managing cash flows, and risk assessments could help prevent many mistakes and consequent bankruptcies or restructuring.

The inadequate behaviour of state institutions when SMEs are facing difficulties (such as freezing accounts) paralysed the company's behaviour. This kind of behaviour must change, if SMEs are to make a full contribution to economic development. This includes providing advisory support for SMEs interested in accessing EU structural funds. State institutions do not seem interested in the success of SMEs' projects. Also, mistakes by public officials cannot be changed, whatever a court decides. The decision by the State Social Security Fund to freeze the company's account was illogical and contributed to the company's difficulties. This kind of attitude in state institutions should be eliminated as part of a package of measures to improve the business environment in Lithuania.

The legal regulation of the restructuring process could also be improved by simplifying and shortening procedures, banning the freezing of accounts of companies in difficulties, and by eliminating the requirement to dismiss all employees during restructuring while the dismissal of just some would be enough.

The respondent in this study has identified these major success factors in restructuring:

1. a realistic understanding of the situation;
2. consensus among shareholders;
3. timely advice from lawyers and other consultants;
4. immediate reaction to the situation with a clear andrealistic restructuring plan;
5. court proceedings strengthened the company'snegotiating position with banks;
6. attractiveness of the business.

In future the company will plan any extensions and business development more carefully, assessing all possible risks, and formulating measures to manage those identified. The EU structural funds support brought unexpected complications, with requirements to fulfil public procurement rules (normally not applicable to companies), extra requirements introduced during the implementation of the project, and a different interpretation of whether obligations had been fulfilled.

The liabilities to the bank of all the related companies were too high, and in future the role of the company as guarantor for loans to the other companies should be considered more carefully. Any decision to act as guarantor should take into account the company's abilities to continue to operate effectively if the other companies experience difficulties.

In another similar situation, shareholders agree they would repeat all the actions taken in the restructuring process, just earlier and faster.

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Information sources

Interview

Rimvydas Aniulis, creditor (previous owner of the company),

Secondary sources (in Lithuanian only)

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