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Subject: Creditor Rights Reform Policy Proposal

Executive Summary

As Cameroon undertakes long-run economic development, entrepreneurship has shown to be a promising investment in the sub-Saharan African region. In order to best foster entrepreneurship in Cameroon's domestic economy, R&D expenditure[i] and the diversification of domestic investment should be encouraged through financial sector policy reform via lowering creditor rights[ii] and offering debtors further protection in developing personal credit (Seifert and Gonenc 2012). Specifically, policy reform should encourage the prioritization of reorganization over liquidation in the face of insolvency dilemmas. Developing the financial sector of the economy through the macro accumulation of personal domestic credit increases overall economic development (Puatwoe and Piabuo 2017), and has been an encouraged course of action for Cameroon in particular by both the World Bank and the International Monetary Fund (IMF) (Johannes, Njong, and Cletus 2011).[iii] Encouraging domestic entrepreneurship through personal credit accumulation is one measure that will contribute to these larger goals of the Republic of Cameroon.

The World Bank has reported Cameroon's current bankruptcy system as unsustainable for economic development, yet private companies consider Cameroon's insolvency and bankruptcy system to be above average in protecting the rights of both creditors and debtors (Mbemap 2021). Cameroon's current system is beneficial for private, foreign companies, but does not encourage domestic entrepreneurship as it ought to in an effort to create a sustainable business market for economic development. There is a 15.8 percent recovery rate and a large financial burden placed on the debtor in cases of insolvency. The costs of insolvency proceedings take roughly 46.6 percent of the total value of assets (claim value)[iv] (World Bank Group 2020). Such conditions inhibit domestic investment and domestic entrepreneurial activities. Further, as Cameroon has a lower than average court efficiency, establishing written policy to protect a debtor's right to begin court investigations before a creditor can demand liquidation is essential. Specifically, Cameroon should amend its current insolvency resolution procedures to allow and encourage creditors filing for insolvency from the debtor to strive for reorganization first and foremost. As of 2020, a creditor may only apply for liquidation of debtor's assets in the circumstances of insolvency (World Bank Group 2020).

Evidence

Empirical studies demonstrate that, generally, higher GDP is correlated with increased creditor rights. This correlation is not universal nor proven to be causal, but the statistical pattern is present. The U.S, for instance, has one of the lowest creditor rights scores and one of the strongest economies in global comparative studies[v] (Claessens, Djankov, and Mody 2001).

Empirical evidence suggests that increased creditor's rights and powers in reorganization procedures is an effective policy reform for financial sector investment in well developed economies. By reforming creditor rights in reorganization procedures in 2010, Denmark saw a 0.1 percentage point decrease in firm liquidation likelihood for any given domestic firm (Agrawal and Gonzalez-Uribe 2022). However, for countries with a less developed economy more susceptible to financial crash risks, as Cameroon is considered since the COVID-19 Pandemic (IMF 2020), the risks of increased creditor rights reform outweigh the potential benefits in the long-term development strategy of Cameroon's economy. Cameroon will financially benefit from a long-term oriented strategy in financial liberalization reform policy as a Low-Middle Income Country (LMIC), not short-term gains. Thus, creditor rights protections should be decreased alongside other reforms to the financial sector (Ranciere, Tornell, and Westermann 2006) (World Congress of Nephrology 2020).

Bankruptcy procedures that favor the creditor's rights significantly more than the debtor's have been shown to have an overwhelmingly negative impact on financial investment activity. In 2002 India implemented the SARFAESI Act, a reform that granted creditors the right to seize insolvent debtors' assets immediately after the declaration of insolvency and further allowed creditors to bypass any court or judicial process before doing so. As a result, debt investment as a whole decreased in the financial sector by roughly 0.025 percentage points (Vig 2013). In India's circumstances this was not an inherently negative shift in economic activity, as there were beneficial impacts on the likelihood of a declaration of bankruptcy. However, as Cameroon is exerting effort in long-term economic development as an LMIC through entrepreneurship and business environment reforms, this negative impact on investment and debt activity would impair Cameroon's ability to achieve its long-term goals in economic development.

Cameroon's recent implementation of stronger debtor's rights under OHADA in 2015 has had overwhelmingly positive impacts on Cameroon's investment system and foreign-investor appeal as well as a substantial impact on domestic credit as a ratio to GDP[vi] (Brown Rudnick Group 2016). However, the OHADA report notes that Cameroon has failed to implement insolvency regime reforms that specifically benefit domestic entrepreneurs (IFC and OHADA 2018).

Recommendations

Reducing creditor rights via allowing and encouraging creditors to file for reorganization rather than liquidation when insolvency is declared would encourage riskier and more innovative investments of manager assets, reduce liquidation in the Cameroonian economy, and lead to financial sector development (Johannes, Njong, and Cletus 2011). This proposed liberalization of the credit market of Cameroon would ease access to personal credit gain for managers and entrepreneurs in the domestic business sector. This indirect encouragement of riskier financial investment and diversification would allow increased microeconomic autonomy in managerial decision making. This would in turn create opportunity for increases in personal savings and cost reduction practices for small businesses and microenterprises, increasing overall investment levels in Cameroon's domestic business economy (Brockman and Unlu 2009). This is a measured address to the IMF and the Central African Economic and Monetary Community (CEMAC)'s increasing concerns over Cameroon's specialization and reliance on the global oil market for export-based income (IMF 2020). Diversification of domestic markets is an ongoing project for Cameroon's financial independence as a leading economic figure in COBAC. The explained reform of the domestic business climate would increase opportunities for credit accumulation for microfinance, exaggerating Cameroon's regional economic leadership. Protecting entrepreneurship and financial liberalization for the purposes of domestic financial growth is highly encouraged for Cameroon by the IMF and CEMAC due to its unique positionality in Africa.[vii]

The current credit accumulation constraints in Cameroon (the favoring of liquidation in court procedures and current creditors' legal rights) as of now prevent productive economic entrepreneurship, private sector employment, and growth of the job market (Baliamoune-Lutz, Brixiova, and Ndikumana 2011). Thus, the nation of Cameroon should not only create but further implement and enforce policies that prioritize reorganization of company assets in the case of debtor insolvency as opposed to liquidation and adherence to the creditor's immediate demands. This would enable the financial sector to experience an increase in business participation from domestic actors and a resultant diversification of domestic assets. The policy change proposed would reform the rights of the creditor in the case of debtor insolvency to ensure the debtor's entrepreneurial endeavors are not limited by risk-mitigating actions led by fears of the creditor's powers. Further, it would limit the amount of liquidation, premature quits on debts, and no attempts at reorganization or renegotiation in the financial sector of Cameroon's economy.

Conclusion

Over the past several years, the IMF in conjunction with CEMAC has recommended that Cameroon enact substantial reforms in its business sector, and in doing so achieve overall increased economic development (IMF and World Bank 1999). The long term goal of these recommendations is a reformation of the business climate in Cameroon to encourage financial economic activity by both domestic and foreign actors; specifically investors and potential creditors. Entrepreneurship can be encouraged through multiple economic policy reform avenues, one being an ease to credit access through the limitation of creditor rights. Empirical evidence from India and Romania verify the negative consequences of minimal creditor rights—i.e. the decrease of willing creditor actors in the financial sector—are outweighed by the positive benefits, largely the increases in debtor activity and entrepreneurial endeavors encouraged as a result.

This increased entrepreneurial activity would be coupled with an increased diversification of managerial investment funds and a reduction of liquidity from domestic enterprises, stimulating Cameroon's financial sector activity overall. It is important to mind that policy reform of creditor rights, either in the negative or positive direction, is not a universal solution and is highly conditional to the current business environment of the relevant country. World Bank and IMF rankings of Cameroon's business climate indicate that a negative reform of creditor rights would be subjectively beneficial overall. This path of financial sector reform would encourage slow and steady, as opposed to quick and fluctuating, economic development. It is important the officials of Cameroon prioritize this methodology in the face of the COVID-19 Pandemic's long-term impacts on Cameroon's wealth and global business involvement. This policy reformation, therefore, would prove an overall beneficial economic development strategy for Cameroon's domestic business sector.

APPENDIX

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[i] See:

> Seifert, B. and Gonenc, H. "Creditor Rights and R&D Expenditures." Corporate Governance: An International Review, 20 (2012): 3-20. https://doi.org/10.1111/j.1467-8683.2011.00881.x

For further information on creditor rights and R&D expenditure relationships. The article defines both the positive and negative impacts increased creditor rights may have on entrepreneurial opportunities within a specified economy.

[ii] Creditor rights are most commonly defined using the following set of criteria: (1) right to repossess collateralized assets, (2) right to absolute priority over non-secured creditors (3) right to restrict the debtor from unilaterally seeking court protection, and (4) right to replace management (Brockman and Unlu). Using these criteria, creditor rights are usually scored from a scale of 0-4 for each criteria and combined to give a general overview for a country's business sector. Refer to Doing Business 2020 Report of Cameroon for a more in depth analysis of creditor protection rights in Cameroon as judged by foreign investors and their confidence in engaging in business in Cameroon.

[iii] See:

> Johannes, Njong Tabi Atemnkeng, and Neba Cletus. "Financial development and economic growth in Cameroon, 1970-2005." Journal of Economics and International Finance 3, no. 6 (2011). https://doi.org/10.5897/JEIF.9000052

For further information on entrepreneurial activity in Cameroon. This paper establishes that financial sector growth has and will continue to aid Cameroon's economic development in long-term perspective. Further, see:

Mbemap, Mamouda. "2021 Investment Climate Statements: Cameroon." *U.S. Department of State*. July 21 2021. https://www.state.gov/reports/2021-investment-climate-statements/cameroon/

For the IMF and World Bank recommendations regarding Cameroon's long-term economic development and sustainability.

[iv] See "Doing Business" reports for further details regarding the investment climate of Cameroon and how it has evolved within the past decade. "Doing Business" evaluates the protections of both creditors and debtors within the business sector of Cameroon, summarizing and centralizing IMF and U.S. State Department findings.

[v] The U.S.'s low creditor rights score is mostly attributed to high prioritization of reorganization over liquidation in the case of insolvency or bankruptcy, as well as automatic stay on assets. This denotes that these practices are not inherently harmful to a business sector, but rather their impacts are highly subjective to the circumstances of a given economy in the global economic sphere.

[vi] See BrownRudnick analysis for further information. OHADA, the "Organisation pour l'harmonisation en Afrique du Droit des Affaires," has offered much economic stability to the involved economies. The 2015 Uniform Act on Insolvency and Restructuring is based on very similar economic policy goals as the one being proposed here. Prioritization of reorganization by creditors would enhance the 2015 reforms to the insolvency regime in the OHADA member economies.

[vii] This statement is in reference to Cameroon's status as an emerging African economic power, currently ranked as a Lower Middle Income Country dependent on oil for economic stability but quickly diversifying its domestic markets. The IMF and World Bank have expressed positive outlook for Cameroon's economic development overall within the next few decades.

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