

**AN EXPLORATION OF THE COSTS ASSOCIATED WITH  
BUSINESS RESCUE IN SOUTH AFRICA**

BY

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## TABLE OF CONTENTS

<b>CHAPTER 1: INTRODUCTION</b> .....	<b>2</b>
1.1 BACKGROUND.....	2
1.1.1 Insolvency proceedings.....	2
1.1.2 South African corporate rescue regime.....	3
1.1.3 The success of business rescue in South Africa.....	4
1.2 PROBLEM STATEMENT.....	5
1.3 PURPOSE STATEMENT.....	5
1.4 RESEARCH OBJECTIVES AND RESEARCH QUESTIONS.....	6
1.5 ACADEMIC VALUE AND CONTRIBUTION OF THE STUDY.....	7
1.6 LIST OF ABBREVIATIONS.....	7
<b>CHAPTER 2: PAPER 1</b> .....	<b>10</b>
ABSTRACT.....	10
2.1 INTRODUCTION.....	11
2.1.1 Background.....	11
2.1.2 Problem statement.....	11
2.1.3 Purpose statement.....	12
2.1.4 Research objectives.....	12
2.1.5 Academic value and contributions of the study.....	13
2.2 LITERATURE REVIEW.....	14
2.2.1 Direct costs of reorganisation.....	15
2.2.2 Determinants of direct costs.....	17
2.2.3 Direct costs of business rescue proceedings.....	19
2.3 METHODOLOGY.....	22
2.3.1 Research design.....	22
2.3.2 Phase one: qualitative research methods.....	22
2.3.3 Phase two: quantitative research methods.....	26
2.3.4 Ethical considerations.....	30
2.4 FINDINGS.....	30
2.4.1 Phase one: qualitative findings.....	30
2.4.2 Phase two: quantitative findings.....	44
2.5 CONCLUSION.....	50
2.5.1 Managerial implications.....	53
2.5.2 Limitations and directions for future research.....	53
<b>CHAPTER 3: PAPER 2</b> .....	<b>57</b>

ABSTRACT .....	57
3.1 INTRODUCTION .....	58
3.1.1 Background .....	58
3.1.2 Problem statement .....	59
3.1.3 Purpose statement .....	59
3.1.4 Research questions.....	59
3.1.5 Academic value and contributions of the study .....	60
3.2 LITERATURE REVIEW .....	60
3.2.1 The costs of financial distress .....	61
3.2.2 Sources of indirect costs .....	63
3.3 METHODOLOGY .....	71
3.3.1 Research design .....	71
3.3.2 Sampling .....	72
3.3.3 Data collection.....	73
3.3.4 Data analysis.....	73
3.3.5 Trustworthiness .....	74
3.3.6 Ethical considerations .....	74
3.4 FINDINGS AND DISCUSSION.....	75
3.4.1 Loss of customer goodwill .....	75
3.4.2 Loss of supplier goodwill .....	78
3.4.3 Decrease in employee morale and productivity.....	81
3.4.4 Key employee and management turnover.....	83
3.4.5 Inability to raise finance .....	86
3.4.6 Inefficient asset sales .....	88
3.5 CONCLUSION.....	89
3.5.1 Managerial implications .....	91
3.5.2 Limitations and recommendations for future research.....	91
<b>CHAPTER 4: SUMMARY AND CONCLUSION .....</b>	<b>93</b>
4.1 INTRODUCTION .....	93
4.2 PAPER 1: SUMMARY AND CONCLUSIONS .....	93
4.3 PAPER 2: SUMMARY AND CONCLUSIONS .....	95
4.4 REFLECTIONS ON THE CONTRIBUTION OF THE STUDY.....	97
4.5 LIMITATIONS OF THE STUDY.....	98
<b>CHAPTER 5: LIST OF REFERENCES .....</b>	<b>101</b>

## APPENDICES

APPENDIX A: Informed consent form and discussion guide .....	114
APPENDIX B: Informed consent form and final questionnaire .....	124
APPENDIX C: Card sort data analysis .....	140
APPENDIX D: Descriptive statistics .....	151
APPENDIX E: Test results: statistical assumptions .....	153
APPENDIX F: Table linking codes to final themes and sub-themes (paper 1) .....	160
APPENDIX G: Table linking codes to final themes and sub-themes (paper 2).....	171

## LIST OF FIGURES

Figure 1: Breakdown of the total direct costs for all 19 companies .....	45
Figure 2: A visualisation of the direct costs of business rescue in South Africa .....	51
Figure 3: A visual depiction of indirect financial distress costs .....	63
Figure 4: Summary of research questions and related themes .....	75
Figure 5: A visual depiction of indirect financial distress costs in South Africa.....	90
Figure 6: Card sort example.....	123
Figure 7: Direct costs as a percentage of total asset value at the commencement date ( $n = 19$ ) .....	152
Figure 8: Histogram and normal probability plot representing the distribution total company size .....	154
Figure 9: Histogram and normal probability plot representing the distribution total duration .....	155
Figure 10: Histogram and normal probability plot representing the distribution total direct costs.....	155
Figure 11: Scatter plot showing the correlation between total direct costs and company size .....	156
Figure 12: Scatter plot showing the correlation between total direct costs and company size where the outliers have been removed.....	157
Figure 13: Scatter plot showing the correlation between total direct costs and duration ..	158
Figure 14: Scatter plot showing the correlation between total direct costs and duration where the outliers have been removed .....	159

## LIST OF TABLES

Table 1: Direct and indirect costs definitions.....	2
Table 2: List of abbreviations and synonyms .....	7
Table 3: Estimates of direct reorganisation costs of previous empirical studies .....	16
Table 4: Participants' profile and identifying characteristics .....	23
Table 5: Profile of the companies in the study .....	28
Table 6: Measures .....	29
Table 7: Final popular placements matrix .....	31

Table 8: Descriptive statistics ( $n = 19$ ) .....	45
Table 9: Descriptive statistics for total BRP fees .....	46
Table 10: Descriptive statistics for professional fees disbursements (S143(1)) .....	46
Table 11: Descriptive statistics for general disbursements (S143(1)) .....	47
Table 12: A correlation matrix displaying the results of the Spearman's rank order correlation for $H_1$ and $H_2$ .....	49
Table 13: A correlation matrix displaying the results of the Spearman's rank order correlation for $H_1$ and $H_2$ where the outliers have been removed .....	50
Table 14: Participants' profile and identifying characteristics .....	72
Table 15: Exploratory interview questions .....	120
Table 16: Component-by-category results matrix .....	142
Table 17: Popular placements matrix.....	145
Table 18: Final popular placements matrix .....	149
Table 19: Kolmogorov-Smirnov test for the variables tested in $H_1$ and $H_2$ .....	154
Table 20: The link between the cost components and direct cost category, the basic remuneration of the BRP (S143(1)) .....	161
Table 21: The link between the cost components and direct cost category, professional fee disbursements (S143(1)) .....	164
Table 22: The link between the cost components and direct cost category, general disbursements (S143(1)).....	166
Table 23: The link between the cost components and direct cost category, contingency fees (success-based fees) (S143(2)) .....	167
Table 24: The link between the codes, sub-themes and the indirect cost source, the loss of customer goodwill .....	172
Table 25: The link between the codes, sub-themes and the indirect cost source, the loss of supplier goodwill .....	174
Table 26: The link between the codes, sub-themes and the indirect cost source, a decrease in employee morale and productivity .....	178
Table 27: The link between the codes, sub-themes and the indirect cost source, key employee and management turnover .....	180
Table 28: The link between the codes, sub-themes and the indirect cost source, the inability to raise finance.....	183
Table 29: The link between the codes, sub-themes and the indirect cost source, inefficient asset sales.....	184

CHAPTER 1:	Introduction	2
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CHAPTER 2:	Paper 1	10
------------	---------	----

CHAPTER 3:	Paper 2	57
------------	---------	----

CHAPTER 4:	Summary and conclusion	93
------------	------------------------	----

CHAPTER 5:	List of references	101
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# AN EXPLORATION OF THE COSTS ASSOCIATED WITH BUSINESS RESCUE IN SOUTH AFRICA

## CHAPTER 1: INTRODUCTION

### 1.1 BACKGROUND

#### 1.1.1 Insolvency proceedings

Companies in financial distress may be subjected to two types of insolvency procedures for dealing with distress, namely, liquidation and reorganisation. Liquidation proceedings consist of stripping the company of its assets and all claims against the company are settled. In turn, reorganisation enables companies to undergo restructuring aimed at returning a company to financial stability by way of implementing a reorganisation plan. Reorganisation may not be suitable for all companies in financial distress; in some instances, the costs of reorganisation may be exorbitant, making this procedure unsuitable. Therefore, the costs associated with insolvency procedures are a key factor to consider when a company makes a choice between liquidation and reorganisation. Literature typically divides these costs into direct and indirect costs. Table 1 provides the definitions of direct and indirect costs used for the purposes of this study.

**Table 1: Direct and indirect costs definitions**

Direct costs	Indirect costs
Direct costs can be defined as the transaction costs (the out-of-pocket expenses) that are directly related to administering insolvency proceedings. Direct costs include administrative costs such as filing expenses and fees paid to various professionals such as lawyers, accountants, business consultants, turnaround specialists and various other professionals (Altman & Hotchkiss, 2006:93; Armour, Hsu & Walters, 2012:109; Bhabra & Yao, 2011:43).	Indirect costs can be defined as lost opportunities or lost profits that result from a loss of customer and supplier goodwill, a decrease in employee morale and productivity, a loss of key employees and management, the inability to raise finance, and inefficient asset sales (Altman, 1984:1071; Andrade & Kaplan, 1998:1445; Bhabra & Yao, 2011:45; Chen & Merville, 1999:277; Pulvino, 1998:940).

In addition to the costs incurred by the financially distressed company itself, the company's stakeholders directly incur certain other costs. Shareholders, bankers, trade creditors,

government departments, landlords, employees, and others with interests in the company are likely to incur additional costs as a result of the company's financial distress (Branch, 2002:44). In addition, formal insolvency procedures generate more costs, not only for the direct participants (the company and its stakeholders) but also for society. These include the cost of layoffs, low tax collection and a decrease in the supply of goods and services.

### **1.1.2 South African corporate rescue regime**

South African company law has made provision for a formal corporate rescue procedure in the form of judicial management since the inception of the Companies Act No. 46 of 1926 (Loubser, 2010b:2). However, judicial management was never regarded as an effective corporate rescue procedure for companies in financial distress. Despite attempts to improve it by amendments to the relevant legislation, this remained the general view even after the Companies Act No. 61 of 1973 came into operation which effected substantial amendments to the judicial management procedure (Loubser, 2010b:3). According to Burdette (2004:241), it was generally accepted that judicial management was a "dismal failure". One of the main drawbacks of the procedure was the unavoidable involvement of the court, which rendered judicial management a costly, slow, and cumbersome procedure (Loubser, 2010b:43). The costs incurred in running the procedure were so high that it did not make the procedure attractive for the creditors, as all the available cash was spent on the procedure itself (Burdette, 2004:249). In addition, judicial management did not obtain the level of success that the legislators intended. For this reason, liquidation was favoured as the primary insolvency procedure, as it provided a faster and easier method for creditors to receive payment (Rabilall, 2018:1).

Business rescue proceedings replaced the judicial management procedure and came into effect on 1 May 2011 after it was introduced into Chapter 6 of the Companies Act No. 71 of 2008 ('the Act'). Business rescue provides for temporary measures to facilitate the rehabilitation of financially distressed companies. Once proceedings commence, the company's management is placed under the supervision of a business rescue practitioner ('BRP') and a moratorium on the rights of claimants against the company will operate (Bradstreet, 2010:195). Business rescue offers distressed companies an alternative to liquidation as the aim is not to strip the company of its assets but to provide the company

with the opportunity to restructure its affairs in order to return the company to financial stability (Cassim, 2012:458). If that is not possible, the aim is to restructure the affairs of the company in a way that results in a better return for the company's creditors than would result from the immediate liquidation of the company (Bradstreet, 2010:195). In addition to supporting the rehabilitation of financially distressed companies, business rescue can support the government with its macroeconomic objective of growing the economy and reducing unemployment (Conradie & Lamprecht, 2015:22).

### **1.1.3 The success of business rescue in South Africa**

The success of business rescue is important to various stakeholders in the company, such as employees, creditors, financiers, and shareholders (Conradie & Lamprecht, 2018:1). Despite its importance, the success rate of business rescue in South Africa is seemingly low (Naidoo, Patel & Padia, 2018:1). As at December 2015, the success rate was 13.94% and increased to 15.85% as at December 2016. As at the end of March 2018, this had increased to 16.74% (Companies and Intellectual Property Commission, 2015:1; Companies and Intellectual Property Commission, 2016:1; Companies and Intellectual Property Commission, 2018:3). In this instance, success refers to the number of companies that have filed for substantial implementation of business rescue proceedings (Naidoo *et al.*, 2018:2). However, it must be noted that current statistics on the success rate have been described as "inconsistent with unreliable validity" (Pretorius, 2015:32).

Several factors have been identified as factors contributing to the low success rate of business rescue proceedings. These factors include, but are not limited to, the following: the lack of post-commencement finance ('PCF'), the skills of the BRP, the inconsistency of court judgements, delayed filing, and the rights of affected parties (Naidoo *et al.*, 2018:2; Pretorius & Du Preez, 2013:168; Winer & Crook, 2016:3). However, the costs of business rescue have been increasingly criticised and blamed for the low success rates. Although the removal of court oversight has made business rescue cheaper, the cost of business rescue is still argued to be substantial (Bradstreet, Pretorius & Mindlin, 2015:16). BRP fees and associated expenses have been blamed for contributing to the worsening reputation of the business rescue regime.

## **1.2 PROBLEM STATEMENT**

Understanding the costs associated with insolvency proceedings is important for several reasons. Firstly, understanding the direct costs are important for a financially distressed company's choice between liquidation and reorganisation (White, 1989:138). Secondly, indirect costs may cause an even faster deterioration of the operating performance of a company that is already in financial distress and as a result, may impede the success of a reorganisation attempt (Searle, 2013:19). Despite the importance of understanding the costs associated with administering business rescue, little is known about the direct and indirect costs of business rescue within the South African context. The general perception in South Africa is that business rescue might well be overly costly (Le Roux & Duncan, 2013:63; Loubser, 2010b:114; Searle, 2013:40). However, research has not yet been able to establish with certainty either the nature or quantum of such costs (Bradstreet *et al.*, 2015:16). In view of this scenario, this study explored the direct and indirect costs of business rescue proceedings in South Africa.

## **1.3 PURPOSE STATEMENT**

The purpose of this study was to explore the direct and indirect costs of business rescue proceedings in South Africa. Such an analysis was made by conducting two studies.

In the first study, the researcher explored the direct costs of business rescue in South Africa by conducting an exploratory sequential mixed methods study. The first phase of the study was a generic qualitative exploration to identify the direct costs of business rescue and the components of the direct costs. During this phase, qualitative data were collected from BRPs. From the initial exploration, the qualitative findings were used to develop an instrument that was administered to a sample of BRPs in order to measure the direct cost components of business rescue proceedings for companies that were previously under business rescue in South Africa. In addition, the study examined the relationship between the direct costs of business rescue and considered variables, such as company size and duration of business rescue proceedings. The findings of which can be found in chapter 2.

In the second study, the researcher conducted a qualitative exploration of the indirect costs of financial distress companies face, as a consequence of participating in business rescue proceedings in South Africa. The focus was specifically placed on investigating and identifying the sources of indirect costs associated with business rescue. The findings of this study are presented in chapter 3.

#### **1.4 RESEARCH OBJECTIVES AND RESEARCH QUESTIONS**

The first objective of the study was to identify the direct costs of business rescue proceedings in South Africa. In relation to the above, this study aimed to achieve the following three sub-objectives:

- To measure the direct costs of business rescue proceedings for companies that were previously under business rescue in South Africa.
- To investigate the relationship between the direct costs of business rescue and the size of the company.
- To investigate the relationship between the direct costs of business rescue and the duration of business rescue proceedings.

The second objective of the study was to identify the indirect costs of business rescue proceedings. In order to address the above objective, the study aimed to answer the following question:

- What indirect costs do companies experience while undergoing business rescue proceedings in South Africa?

Indirect costs are unobservable in nature and are, therefore, difficult to specify and empirically measure. As a result, this study expanded on this question by focusing on and investigating six important sources of indirect costs that were identified in the literature. The specific questions that were answered through this research study were extended to include:

- Do companies experience a loss of customer goodwill during business rescue?
- Do companies experience a loss of supplier goodwill during business rescue?

- Do companies experience a decrease in employee morale and productivity during business rescue?
- Do companies experience a high turnover of key employees and management during business rescue?
- Do companies face challenges in raising finance during business rescue?
- Do companies sell assets at depressed prices during business rescue?

## 1.5 ACADEMIC VALUE AND CONTRIBUTION OF THE STUDY

The study explored the direct and indirect costs associated with business rescue in South Africa. By doing so, it makes several contributions to existing business rescue literature. Firstly, as far as could be determined, there are no studies exploring the costs associated with business rescue proceedings in South Africa. This observation demonstrates the originality of the study. Secondly, by exploring the direct and indirect costs for South African companies, the study may provide the first insights into a potential comparison of these costs with studies conducted in other jurisdictions. In addition, the results of the study may assist BRPs, affected parties, as well as future affected companies to understand the costs associated with business rescue.

## 1.6 LIST OF ABBREVIATIONS

Table 2 provides the abbreviations and synonyms used throughout the dissertation.

**Table 2: List of abbreviations and synonyms**

Abbreviation	Description
Affected party	Affected party is also known as an affected person. According to Section 128 of the Act an affected person refers to: a shareholder or creditor of the company; any registered trade union representing employees of the company; and if any of the employees of the company are not represented by a registered trade union, each of those employees or their respective representatives
B2B	Business-to-business

<b>Abbreviation</b>	<b>Description</b>
B2C	Business-to-consumer
BR	Business rescue
BRP	This acronym is used to refer to 'Business rescue practitioner'. Other synonyms for business rescue practitioner may include administrator and practitioner
Business rescue	Synonyms include: corporate rescue, proceedings, rescue, reorganisation, reorganization, restructuring, turnaround
CIA	Cash-in-advance, cash-in-account
CIPC	Companies and Intellectual Property Commission
COD	Cash-on-delivery
PCF	Post-commencement finance
the Act	The Companies Act No. 71 of 2008
UP	University of Pretoria

CHAPTER 1: Introduction 2

CHAPTER 2: Paper 1 10

CHAPTER 3: Paper 2 57

CHAPTER 4: Summary and conclusion 93

CHAPTER 5: List of references 101



## CHAPTER 2: PAPER 1

### TITLE: AN INVESTIGATION OF THE DIRECT COSTS OF BUSINESS RESCUE: A SOUTH AFRICAN PERSPECTIVE

#### ABSTRACT

**Background:** The direct costs associated with business rescue proceedings are integral to the decision-making of directors, business rescue practitioners and other affected parties. Business rescue has been criticised for being a costly procedure, but what constitutes these costs and how they are defined remain largely unknown.

**Purpose:** This research set out to explore the direct costs of business rescue proceedings in South Africa. More specifically, the study set out to identify and measure the direct costs of business rescue. In addition, the study examined the relationship between the direct costs and the following variables: company size and duration of business rescue proceedings.

**Method:** An exploratory sequential mixed methods research design was employed in this study. Phase one, which consisted of semi-structured interviews supplemented by a closed card sort with 14 business rescue practitioners, resulted in direct cost categories and components that were used to develop a survey instrument. A survey was conducted in phase two, whereby the direct costs were measured for 19 companies that were previously under business rescue in South Africa.

**Results:** The results of phase one show that the direct costs of business rescue consist of four categories, namely; the basic remuneration of the business rescue practitioner, contingency fees, professional fee disbursements and general disbursements. Given the small sample size, the results of phase two were inconclusive.

**Conclusion:** The results may assist affected parties as it offers some insight and clarity as to the nature and magnitude of the direct costs of business rescue proceedings.

**Keywords:** *Financial distress, insolvency, reorganisation, business rescue, direct costs, measurement, South Africa*

## 2.1 INTRODUCTION

*“Measurement is the first step that leads to control and eventually to improvement. If you can’t measure something, you can’t understand it. If you can’t understand it, you can’t control it. If you can’t control it, you can’t improve it.” – H. James Harrington*

### 2.1.1 Background

Business rescue, the formal reorganisation procedure introduced into Chapter 6 of the Companies Act No. 71 of 2008 (‘the Act’), came into effect in May 2011. The Act defines business rescue as proceedings to facilitate the rehabilitation of a financially distressed company through the temporary supervision of the company’s affairs, business and property. Reorganisation proceedings generate costs, not only for the distressed company and its stakeholders but also for society (Branch, 2002:39). The costs of reorganisation can be divided into direct and indirect costs (Armour *et al.*, 2012:109). However, the focus of this study is on direct costs of business rescue incurred by the distressed company.

Direct costs can be defined as the transaction costs (the out-of-pocket expenses) that are directly related to administering reorganisation proceedings. These costs include administration costs such as filing fees and include fees paid to professionals such as lawyers, accountants, business consultants, turnaround specialists and various other professionals (Altman & Hotchkiss, 2006:93; Armour *et al.*, 2012:109; Bhabra & Yao, 2011:43). A number of studies conducted in various jurisdictions, mainly in Canada, United Kingdom and the United States, show a substantial variation in the direct costs of reorganisation and these studies offer mixed conclusions on the magnitude of direct costs (Citron & Wright, 2008:71; Gine & Love, 2010:3). However, the findings of these studies cannot be generalised to the South African context.

### 2.1.2 Problem statement

Understanding the costs associated with reorganisation proceedings is important to assess the efficiency of the system (Citron & Wright, 2008:71; Ferris & Lawless, 2000:629). Despite the importance of understanding reorganisation costs, surprisingly little is known about the

size and determinants of the direct costs of business rescue in the South African context. Business rescue has been criticised for being a costly procedure with low success rates (at just 16.74% at March 2018) (Companies and Intellectual Property Commission, 2018:3; Le Roux & Duncan, 2013:63; Loubser, 2013:514; Pretorius, 2015:37). According to Bradstreet *et al.* (2015:16), business rescue practitioner ('BRP') fees and other associated business rescue costs have been blamed for worsening the reputation of business rescue proceedings; however, research has not been able to establish the nature or magnitude of such costs. Direct costs of reorganisation procedures have been examined in various jurisdictions; however, these findings cannot be generalised to South Africa. As a result, this study aimed to fill this gap.

### **2.1.3 Purpose statement**

The purpose of this exploratory sequential mixed methods study was to explore the direct costs of business rescue proceedings in South Africa. The first phase of the study was a generic qualitative exploration to identify the direct costs of business rescue and the components of the direct costs. During this phase, qualitative data were collected from BRPs. From the initial exploration, the qualitative findings were used to develop an instrument that was administered to a sample of BRPs to measure the direct cost components of business rescue proceedings for companies that were previously under business rescue in South Africa. In addition, the study examined the relationship between the direct costs of business rescue and the following variables: company size and duration of business rescue proceedings.

### **2.1.4 Research objectives**

The main objective of this study was to identify the direct costs of business rescue proceedings in South Africa. In relation to the above, this study aimed to achieve the following sub-objectives:

- To measure the direct costs of business rescue proceedings for companies that were previously under business rescue in South Africa.

- To investigate the relationship between the direct costs of business rescue and the size of the company.
- To investigate the relationship between the direct costs of business rescue and the duration of business rescue proceedings.

### **2.1.5 Academic value and contributions of the study**

There is a gap in the current literature relating to the direct costs associated with business rescue proceedings. This study aimed to exploit this gap by exploring the direct costs associated with business rescue. The study aimed to identify the direct costs of business rescue and the components of the direct costs. By identifying and describing these direct costs, the findings may offer affected parties some insight and clarity as to the nature of these costs. Moreover, these findings may initiate further exploration into the topic.

The qualitative findings provided a basis for the researcher to develop an instrument in order to measure the direct costs for companies that were previously under business rescue in South Africa. The researcher was able to examine the relationship between the direct costs of business rescue and the following variables: company size and duration of business rescue proceedings. In doing so, the researcher is able to facilitate a better understanding of the size and determinants of the direct costs associated with these proceedings. If the costs of business rescue are as high as claimed to be, these costs could be a key factor contributing to the low success rate of business rescue. In this instance, understanding the size and determinants of business rescue costs is necessary before the legislator and regulator can discuss ways to reduce these costs (Betker, 1997:57). Conversely, if direct business rescue costs are insignificant, then it may be concluded that the prospects for a successful reorganisation may be a function of various characteristics of the company (Campbell, 1997:22).

The approach followed in this article is as follows: first, it presents a literature review on the direct costs of reorganisation proceedings; this includes a summary of the determinants of the direct costs of reorganisation and a brief overview of the direct costs of business rescue in South Africa. The second section of this article focuses on the research methodology, which discusses the qualitative research approach first, followed by the quantitative

research approach used in this study. Thereafter the qualitative findings are discussed. Next, the quantitative findings are discussed in terms of descriptive statistics and hypotheses testing. The article is concluded with a summary of the findings, managerial implications, limitations and recommendations for future research are offered.

## **2.2 LITERATURE REVIEW**

Many jurisdictions around the world offer financially distressed companies two distinct insolvency procedures for dealing with distress. First, for companies that see no prospect of being able to operate successfully in the future, there is liquidation (Yang, Birge & Parker, 2015:2320). With liquidation proceedings, a liquidator is appointed to close the company down, sell its assets, and the proceeds are distributed to creditors (Yeats, 2012:502). Alternately, for companies that wish to continue operating, there is reorganisation. The goal of a reorganisation is to give the company a temporary opportunity to reorganise the business and emerge as a commercially viable entity (White, 1989:138).

In South Africa, reorganisation is known as business rescue, and is found in Chapter 6 of the Act. Business rescue facilitates the rehabilitation of a financially distressed company by allowing for the company's affairs, business and property to be placed under a BRP's temporary supervision. Furthermore, the company is provided with a temporary moratorium on all claims against the company or property in the company's possession (Bradstreet, 2010:195). Lastly, the Act provides for the development and implementation of a business rescue plan. The plan serves to restructure the affairs of the company in order to return the company to financial stability. If that is not possible, the aim is to restructure the affairs of the company in a manner that results in a better return for creditors or shareholders than would result from the immediate liquidation of the company (Bradstreet, 2010:195; Cassim, 2012:458).

When a financially distressed company is faced with the decision to liquidate or enter reorganisation proceedings, the goal should be to select the option that is most efficient and maximises the overall value for affected parties (Gilson, 2012:25). The decision regarding whether to reorganise or liquidate the company is critical because of the inherent costs that accompany each choice. If a company elects to reorganise when it is not economically viable

and should be liquidated, then resources are wasted as the company attempts to engage unsuccessfully in a reorganisation (Adams, 1993:598).

Insolvency costs play a key role in a company's decision between reorganisation and liquidation, therefore, it is of interest to know the magnitude of these costs (Fisher & Martel, 2005:151; White, 1989:146). Research typically divides these costs into two categories: direct costs and indirect costs. Direct costs can be defined as the transaction costs (the out-of-pocket expenses) that are directly related to administering proceedings. These costs include administration costs such as filing expenses and fees paid to professionals such as lawyers, accountants, business consultants, turnaround specialists and various other professionals, as mentioned (Altman & Hotchkiss, 2006:93; Armour *et al.*, 2012:109; Bhabra & Yao, 2011:43). In contrast, indirect costs can be defined as lost opportunities or lost profits that result from a loss of customer and supplier goodwill, a decrease in employee morale and productivity, a loss of key employees and management, the inability to raise finance, and inefficient asset sales (Altman, 1984:1071; Andrade & Kaplan, 1998:1445; Bhabra & Yao, 2011:45; Chen & Merville, 1999:277; Pulvino, 1998:940).

### **2.2.1 Direct costs of reorganisation**

According to Branch (2002:43) and Citron and Wright (2008:76), the direct costs of administering a reorganisation largely comprises of fees paid to various professionals. Financially distressed companies usually employ external professionals, specifically lawyers, accountants, turnaround specialists, and various others who tend to charge substantial hourly fees (Branch, 2002:42). In South Africa and the United Kingdom, a “practitioner in possession” regime is used whereby an administrator ('practitioner') is appointed to oversee reorganisation proceedings (Pretorius & Rosslyn-Smith, 2014:116). In addition to overseeing reorganisation proceedings, the practitioner is required to engage in several types of accountability related actions, such as calling and conducting creditors meetings and preparing and circulating reports to creditors (Armour *et al.*, 2012:111). A number of other secretarial tasks fall to the practitioner, such as assembling a list of creditors and determining whether creditor claims are legitimate (Fisher & Martel, 2005:159). All these actions may result in increased costs of reorganisation proceedings. Armour *et al.* (2012:111) report that there is a real process cost involved with conducting creditors'

meetings and preparing a paper trail to guard against legal liability. Typically, these costs will include the fee charged by the practitioner, the legal costs associated with proceedings and miscellaneous charges such as photocopying and telephone bills (Fisher & Martel, 2005:159).

Several studies have investigated the direct costs for reorganisation procedures and these studies were prevalently based on samples of companies from the United States. As a control for company size, the results are typically reported as a ratio of total company value. Possible measures for company value include the value of pre-bankruptcy assets, either at book or estimated market value, and the market value of post-bankruptcy assets (Armour *et al.*, 2012:109). Table 3 summarises the results of these studies.

**Table 3: Estimates of direct reorganisation costs of previous empirical studies**

<b>Author</b>	<b>Time period</b>	<b>Sample</b>	<b>Estimated costs</b>
Altman (1984)	1974 – 1978	19 Chapter 11 cases; mean assets \$110 million before filing	Mean 4% (median 1.7%) of company value just prior to bankruptcy for 12 retailers; 9.8% (6.4%) for 7 industrial companies.
Betker (1997)	1986 – 1993	75 traditional Chapter 11 cases; 48 prepackaged Chapter 11 cases; mean assets FYE before restructuring \$675 million	Traditional Chapter 11 mean 3.93% (median 3.37%) of prebankruptcy total assets; Prepackaged Chapter 11 cases mean 2.85% (median 2.38%)
Bris, Welch and Zhu (2006)	1995 – 2001	Over 300 Chapter 11 cases (mean prebankruptcy assets \$19.8 million)	Mean 9.5%, median 2%
LoPucki and Doherty (2004)	1998 – 2002	48 Chapter 11 cases, mean assets at filing \$480 million	Mean professional fees equal 1.4% of assets at the beginning of the case
Lubben (2000)	1994	22 Chapter 11 cases; median assets \$50 million	Cost of professional fees in Chapter 11 averages 1.8% (median 0.9%) of total assets at beginning of case; 2.5% excluding prepacks
Tashjian, Lease and McConnell (1996)	1986 – 1993	39 prepackaged Chapter 11 cases; mean book value assets FYE before filing \$570 million	Mean 1.8%, median 1.45% of book value of assets at FYE preceding filing

Source: Altman and Hotchkiss (2006:95-96).

Notes: FYE = Financial year-end.

The results of the studies offer mixed conclusions as these studies cover a wide variety of companies and there is great variation in sample sizes covered in these studies (Bris *et al.*, 2006:1254; Fisher & Martel, 2005:157). The range of estimated costs is quite wide, as means range from 1% to about 10% of company size.

## **2.2.2 Determinants of direct costs**

### **2.2.2.1 *Company size***

A number of studies conducted in various jurisdictions report that the size of the company is a significant determinant of direct costs (Campbell, 1997:27; LoPucki & Doherty, 2004:113). The greater the value of assets at stake and the larger the number of creditors, the more effort will be required in reorganisation proceedings as more issues are likely to arise (Armour *et al.*, 2012:110; LoPucki & Doherty, 2008:989). In reorganisation cases with multiple creditors, conflicts of interest between creditors often arise. The presence of multiple creditors may increase information costs, as there may be difficulties in reaching consensus among multiple parties. If different creditors have different and conflicting objectives, the variety of pressures placed on the practitioner and the coordination problems may increase the costs of reorganising the company (Altman & Hotchkiss, 2006:102; Citron & Wright, 2008:74). As a result, as the level of complexity increases, distressed companies usually hire an increased number of professionals with certain skill sets resulting in increased reorganisation costs (Altman & Hotchkiss, 2006:102).

Although it is argued that direct costs increase with company size, several studies state that as the size of the company increases, the direct costs decrease as a percentage of company size (Ferris & Lawless, 2000:653; LoPucki & Doherty, 2004:113). This is referred to as the scale effect. The existence of the scale effect is often due to the presence of fixed costs that can be amortised over larger volumes of company size and as a result, reduce the total percentage of reorganisation costs (Ferris & Lawless, 2000:653). The following hypothesis is thus stated:

H<sub>1(alt)</sub>: There is a significant relationship between company size and the direct costs of business rescue.



### **2.2.2.2 Duration of proceedings**

A number of studies report that the costs of reorganisation increase with the time spent in proceedings (Altman & Hotchkiss, 2006:98; Andrade & Kaplan, 1998:1486; Armour *et al.*, 2012:110; Ferris & Lawless, 2000:657). Professionals use the analogy of the “burn rate” of a rocket to refer to the rate at which their monthly fees are accruing to illustrate the above. This analogy suggests that the direct costs of reorganisation are principally a function of the length of the proceedings (LoPucki & Doherty, 2004:128; LoPucki & Doherty, 2008:990). The practitioners’ and professionals’ fees are often time-based and therefore these fees and other direct costs may be expected to increase the longer reorganisation continues (Branch, 2002:42; Citron & Wright, 2008:76).

Coordination problems with the company’s stakeholders may lead to longer reorganisation proceedings and as a result, direct costs are likely to increase (Citron & Wright, 2008:76). As direct costs are expected to increase with time, the value of the company is presumed to decrease as stakeholders deplete the company’s resources in a disagreement over the division of the value of the company (Andrade & Kaplan, 1998:1486). In this instance, Weiss and Wruck (1998:58) argue that agency problems arise and therefore, stakeholders will support a value-destroying reorganisation so long as the value of their “piece of the pie” is greater than that expected from a value-maximising alternative. In contrast, Haugen and Senbet (1978:389) argue that stakeholder bargaining may not affect the company value.

There are several other factors that may increase the duration of proceedings such as; the number of times creditors request revisions of the proposed plan, external and environmental factors, legal proceedings initiated by affected parties, and the sources of post-commencement finance (‘PCF’) sought (Pretorius, 2015:34). In a study conducted by Pretorius (2015:35), legal proceedings were identified as the key cause for extending proceedings. Although the direct costs of reorganisation are expected to increase with time, LoPucki and Doherty (2004:128) state that as time in reorganisation increases, direct costs increase but at a declining rate. This indicates the existence of the scale effect in the “burn rate”, therefore, highlighting the presence of fixed costs (LoPucki & Doherty, 2004:128; LoPucki & Doherty, 2008:1004). However, it is argued that direct costs are a function of time spent in reorganisation, therefore, it is hypothesised that:

H<sub>2(alt)</sub>: There is a significant relationship between duration and the direct costs of business rescue.

### **2.2.3 Direct costs of business rescue proceedings**

According to Section 143 of the Act, as read with Regulation 128 of the Act, a BRP may charge the company fees calculated on an hourly basis. The basic remuneration of a BRP is determined depending on the size of the company as defined by its Public Interest Score (Turnaround Management Association, 2015a:1). The following tariffs are prescribed in Regulation 128 of the Act and may not be exceeded:

- R 1 250 per hour, to a maximum of R 15 625 per day, (inclusive of VAT) in the case of a small company;
- R 1 500 per hour, to a maximum of R 18 750 per day, (inclusive of VAT) in the case of a medium-sized company; or
- R 2 000 per hour, to a maximum of R 25 000 per day, (inclusive of VAT) in the case of a large company, or a state-owned company.

According to Levenstein (2015:290), there is no limit to what a BRP can charge as their fees are dependent on the duration of proceedings. The following items are considered as acceptable as a guideline for the calculation of a BRP's basic remuneration (Turnaround Management Association, 2015a:2):

- time spent in acting as the BRP of the company;
- any travelling time incurred by the BRP in the discharge of duties and responsibilities; and
- any planning, preparation and assessments completed or undertaken by the BRP in the discharge of their duties.

Regulation 128 further specifies that the company pay for the costs and disbursements incurred by the BRP that are reasonably necessary to carry out their functions and facilitate proceedings. However, the Act does not specify what these costs and disbursements entail (Levenstein, 2015:481). Costs and disbursements may include travelling expenses and any

other costs and expenses reasonably incurred by the BRP, including professional indemnity insurance.

These costs and disbursements further include the costs of appointing various professionals to assist the BRP in carrying out their functions (Baatvedt, 2014:23; Turnaround Management Association, 2015a:5). According to Baatvedt (2014:23), BRPs are commonly faced with a company with unreliable or incomplete information, and dysfunctional management. In this instance, the BRP has the power to appoint an advisor to assist with finding a proper solution. These professionals may include, but are not limited to, lawyers, specialist advisors, valuers, and second/co-appointed BRPs (Pretorius, 2015:37). In a study conducted by Pretorius (2015), BRPs indicated that making use of professionals is necessary to comply with time prescriptions and may assist with completing the business rescue quickly.

According to Section 143 of the Act, the BRP and the company may enter into an agreement providing for further remuneration on a contingency basis relating to:

- the adoption of a business rescue plan at all, or within a certain time, or the inclusion of any particular matter within such a plan; or
- the attainment of any result or combination of results relating to the business rescue proceedings.

Contingency fees, also referred to as “success-based fees”, should be clearly aligned with milestones set out in the business rescue plan. Contingency fees must be approved by the holders of a majority of the creditors’ voting interests at the requisite meetings called to consider such an agreement. As a result, contingency fees vary from case to case (Levenstein, 2015:423; Turnaround Management Association, 2015a:3).

According to Levenstein (2015:424), contingency fees are being agreed to on the basis of percentage payments in line with objectives that are set out to be achieved during the course of proceedings and/or on the implementation of the business rescue plan. In addition, contingency fees may be linked to values achieved on the sale of the company’s assets. The Turnaround Management Association (2015a:3) recommends that a contingency fee based purely on a percentage of the asset realisations should be avoided unless the

purpose of the business rescue is to conduct an informal wind-down. In the case of a wind-down, it is recommended that the BRP should receive a percentage only after a minimum threshold has been achieved.

There are mixed opinions on whether BRPs should be charging contingency fees. According to the Turnaround Management Association (2015a:3), contingency fees may encourage the desired behaviour from BRPs that may benefit the company, its creditors, and shareholders. Furthermore, BRPs take on cases in their personal capacities and assume various risks; as a result, the BRP should be rewarded accordingly should the proceedings be successful. In contrast, the study conducted by Pretorius (2015), revealed that creditors are of the opinion that contingency fees make BRPs hold on to business rescue cases where no reasonable prospect exists. When it comes to contingency fees that are paid at the end of proceedings, Rapoport (2010:281) opines that unless “success” is clearly defined, there may be an incentive to bring the proceedings to a rapid end in order to claim that fee.

In a liquidation scenario, the question of incurring costs and expenses is easy to answer. In liquidation, the costs can be taxed and approved by the Master of the High Court. This question is not so easy to answer when it comes to business rescue as there is no independent control over the costs (Baatvedt, 2014:23). A review of the literature has highlighted the fact that research has not yet established the nature or size of the direct costs of business rescue. It appears that there are mixed opinions on what a BRP is entitled to charge, however, the issue is not about what the BRP may charge on an hourly basis. The Act and Regulations prescribe an hourly tariff that a BRP may charge. The issue lies with the fact that the Act allows for the BRP to be reimbursed for all costs and disbursements; however, the Act does not prescribe what these costs and disbursements may entail. Currently, there are no mechanisms in place to ensure that the fees, especially professional fees, stay within reasonable limits. As far as the additional remuneration is concerned, the Act is not prescriptive regarding what a BRP may or may not charge (Turnaround Management Association, 2015a).

The aforementioned discussion has highlighted that there is a need to identify what the direct costs of business rescue consists of in order to provide affected parties with a clearer and more comprehensive understanding of these costs. In addition, there is a need to

understand the size and determinants of the direct costs as this is important before the legislator and regulator can discuss ways to reduce these costs (Betker, 1997:57).

## **2.3 METHODOLOGY**

### **2.3.1 Research design**

In order to explore the direct costs of business rescue proceedings in South Africa, the study employed a mixed methods research design. Mixed method research uses quantitative and qualitative data collection techniques and analysis procedures either at the same time or one after the other (Saunders, Lewis & Thornhill, 2009:152). The specific mixed method strategy followed in this study was one of sequential exploratory research whereby qualitative interviews were conducted in phase one followed by a quantitative survey in phase two (Creswell, 2014:276). Since the direct costs of business rescue proceedings in South Africa were unknown, the study began by determining the components of the direct costs.

The qualitative phase was used to 1) identify the direct costs of business rescue proceedings as well as the components of these costs, and 2) use the results of the qualitative phase to develop a survey instrument to measure the direct costs. The quantitative phase was used to 1) measure the direct costs of business rescue proceedings, identified in the qualitative phase, for companies that were previously under business rescue in South Africa; 2) to investigate the relationship between the direct costs of business rescue and the size of the company; and 3) to investigate the relationship between the direct costs of business rescue and the duration of business rescue proceedings.

### **2.3.2 Phase one: qualitative research methods**

The main purpose of the qualitative study was to identify the direct costs of business rescue and the components of these costs. The qualitative phase assisted in developing a measurement instrument in order to measure these costs for companies that were previously under business rescue in South Africa.

### 2.3.2.1 Sampling

The units of analysis for phase one of this study were licensed BRPs. The sample consisted of 14 BRPs from Gauteng in South Africa. The final sample size was deemed to be sufficient as the guidelines of Guest, Bunce and Johnson (2006:61) state that six to 12 interviews are sufficient for qualitative research. Table 4 provides the profiles and identifying characteristics of the individual participants, who were all males. The fact that all participants were male is a reflection of the characteristics of the BRP population.

**Table 4: Participants' profile and identifying characteristics**

<b>Pseudonym</b>	<b>License</b>	<b>Background</b>	<b>Duration of the interview (minutes)</b>
BRP01	Senior	Finance	37
BRP02	Senior	Finance	15
BRP03	Senior	Business	44
BRP04	Junior	Legal	40
BRP05	Senior	Accounting	91
BRP06	Senior	Banking	28
BRP07	Senior	Liquidations	27
BRP08	Experienced	Accounting	45
BRP09	Senior	Banking	37
BRP10	Senior	Accounting	28
BRP11	Senior	Legal	35
BRP12	Junior	Accounting	33
BRP13	Junior	Legal	32
BRP14	Senior	Banking	29
	<b>Average:</b>		<b>37</b>

Purposive sampling, a non-probability sampling method, was used to select individual participants for this phase of the study. Purposive sampling is a method where the researcher's judgement is used to select participants who are "information rich" and that will best answer the research question (Creswell, 2012:206; Daniel, 2012). The criteria applied in the selection of participants were as follows: 1) participants had to hold a junior, experienced, or senior BRP license; and 2) participants had to be involved in or administered, a minimum of one business rescue case. In addition to purposive sampling, this study made use of snowball sampling to access participants for this study. The sampled

participants were based on the recommendation of others such as based on the recommendation of the researcher's supervisors, and participants who agreed to take part in this research (Creswell, 2012:209).

### **2.3.2.2 Data collection**

Data for the qualitative phase were collected through 14 one-on-one semi-structured interviews. In addition to semi-structured interviews, the study made use of a card sorting technique to supplement the discussion guide. The basic principle behind the card sorting technique is to ask participants to sort cards into categories (Rugg & McGeorge, 2005:95). According to Paul (2014:88), card sorting is a method used to elicit participants' knowledge and underlying mental models about a conceptual domain. The card sort method allows participants to sort through word or phrase cards which may elicit ideas that would otherwise remain unarticulated, thus promoting a general discussion (Crilly, Blackwell & Clarkson, 2006:342).

In this study a closed card sort was used, whereby the researcher provided participants with categories and participants only had to choose which of the cards belong to a given category (Fincher & Tenenberg, 2005:89; Rugg & McGeorge, 2005:95). The researcher provided participants with four direct cost categories and the components that make up these categories were printed on cards. Participants were instructed to:

- sort the cards into one of the predefined categories;
- speak out-loud throughout the process, while stating the rationale for placing each card into the specific category;
- use the category called "not applicable" for cards that participants felt are not part of the direct costs of business rescue; and
- use blank cards to create new cards for any cost components participants felt were missing.

In each session, the researcher observed participants and answered any questions the participants had during the exercise. Based on the recommendation of Spencer (2009:100), if participants wanted to place a card in two categories, the participant was asked to identify

the category within which it was a better fit. This category was then used for the analysis. At the end of the sorting exercise, participants were interviewed.

Data collection, for the qualitative phase of the study, was conducted between February and May 2018. The 14 interviews lasted from 15 minutes to 91 minutes with an average duration of 37 minutes (see Table 4). The interviews were conducted at the participant's offices or at a boardroom at the University of Pretoria. All 14 interviewees granted the researcher permission to audio record the interviews. The researcher transcribed all 14 interviews within 72 hours after each interview. Thereafter, the researcher listened to each recording while reading the transcripts and, where necessary, made minor changes to the transcripts to ensure an accurate reflection of the recording. The card sort data for each participant was captured into a spreadsheet within 72 hours after each interview.

The discussion guide and the card sort categories and cards were developed from an extensive review of the literature and from analysing business rescue plans. Business rescue plans typically contain a remuneration agreement where the BRP states their hourly rate as well as any other possible costs that may be incurred. A first draft of the discussion guide and card sort was critically pre-tested with the researcher's supervisors. No major changes were made as the supervisors' feedback was positive. A copy of the discussion guide used in the semi-structured interviews, along with an example of the card sort, is included in Appendix A.

### **2.3.2.3 Data analysis**

According to Spencer (2009:129), a simple way to analyse closed card sort data is to document the results using a spreadsheet, with categories placed in the top row and cards placed in the first column. The card sort data were first recorded in a component-by-category results matrix. The results matrix shows the number of times that each card was sorted into the pre-set categories (see Table 16 in Appendix C) (Spencer, 2018). The researcher then created a popular placements matrix showing the percentage of participants who sorted each card into the corresponding category (see Table 17 in Appendix C) (Spencer, 2018). Based on the interview findings, the researcher removed four direct cost components. The



researcher re-named two direct cost categories and nine direct cost components based on the interview findings (see Table 18, Appendix C).

A thematic analysis was conducted to analyse the interview data collected in this study. Braun and Clarke (2012:57) define thematic analysis as a method for systematically identifying, organising, and offering insights into patterns of meaning across a data set. This allowed the researcher to make sense of collective or shared meanings and experiences. Inductive codes were generated from the data and combined with codes identified from the card sort. Therefore, data were coded according to the individual cost components and categories of the card sort (see Table 20 to Table 23 in Appendix F). The findings derived from the thematic analysis was used to inform the findings of the data collected from the card sort.

#### **2.3.2.4 *Trustworthiness***

Four trustworthiness techniques, namely credibility, transferability, dependability, and confirmability were employed to ensure overall trustworthiness of the study's findings (Lincol & Guba, 1985; Polit & Beck, 2012:585). Firstly, to ensure credibility, the researcher employed site triangulation. Site triangulation entails making use of participants from several organisations so as to reduce the effects on the study of particular local factors that are specific to one organisation (Shenton, 2004:66). Secondly, to ensure transferability, the researcher provided a "thick description" of the participants and the study's context (Shenton, 2004:70). Thirdly, to ensure dependability, a comprehensive description of the processes the researcher employed in the study are reported in detail (Shenton, 2004:70). Finally, the researcher stored all notes, transcripts, and audio recordings to ensure confirmability (Milne & Oberle, 2005:416).

#### **2.3.3 Phase two: quantitative research methods**

The main purpose of the quantitative phase was to measure the direct costs and direct cost components identified in the qualitative phase of the study for companies that were previously under business rescue in South Africa. The quantitative phase sought to

investigate the relationship between the direct costs of business rescue and the following variables: 1) the size of the company; and 2) the duration of business rescue proceedings.

### **2.3.3.1 Sampling**

The target population for phase two of this study consisted of companies that were previously under business rescue in South Africa. Since the purpose of the quantitative phase was to measure the direct costs of business rescue, the units of analysis were the 19 companies. This study made use of a non-probability sampling method as the researcher had no access to a sampling frame to draw a probability sample (Cooper & Schindler, 2014:358). Non-probability sampling is an appropriate method to use when it is difficult to gain access to or to locate population elements, as was the case in this study (Daniel, 2012). Data regarding the direct costs of business rescue cases were only available from BRPs, therefore, a non-probability sampling method was deemed appropriate for this study.

The specific non-probability method used in the quantitative phase was purposive sampling. BRPs were given inclusion and exclusion criteria regarding the business rescue cases and ultimately selected the cases to share. For the purposes of this study, participants were asked to exclude special purpose entities which are legal entities created to fulfil narrow, specific or temporary objectives (i.e., companies with the sole purpose of housing a single asset) (Sainati, Brookes & Locatelli, 2016:58). Participants were asked to only include companies where the business rescue plan was published (whether the plan was approved or not approved). Participants had the option of sharing data for up to three business rescue cases. As participants selected which business rescue cases to share, the resulting sample can ultimately be described as a convenience sample.

This study aimed to achieve a minimum sample size of 30 business rescue cases. The researcher asked all 14 participants who took part in the first qualitative phase to complete the questionnaire. Only six participants agreed to complete the questionnaire, resulting in a 43% response rate. Table 5 displays the profile of the companies in the study in terms of the company type and industry. Most of the sample consisted of private companies ( $n = 14$ ) and most of the companies were from the mining and quarrying industry ( $n = 4$ ).

**Table 5: Profile of the companies in the study**

<b>Demographic variables</b>	<b><i>n</i></b>
<b>Type of company</b>	
Private company	14
Closed corporation	4
Non-profit company	1
Total	19
<b>Industry</b>	
Mining and quarrying	4
Manufacturing	3
Transport, storage and communication	3
Financial intermediation, insurance, real estate and business services	3
Wholesale and retail trade	2
Community, social and personal services	2
Construction	1
Repair of motor vehicles and personal and household goods	1
Total	19

### **2.3.3.2 Data collection**

The quantitative data were collected using self-administered questionnaires completed by the participants. The questionnaire was administered electronically using an online platform that allows users to create and distribute questionnaires (see Appendix B). Data were collected during the period of April to June 2018. The survey questionnaire was developed from the qualitative phase findings and consisted of both open and closed questions. Open questions allow participants to give answers in their own way and closed questions provide a number of alternative answers from which the participant is instructed to choose (Saunders *et al.*, 2009:374). The questionnaire provided participants with the option of answering questions on up to three business rescue cases.

During the first qualitative phase, participants were invited to take part in the second phase. Given how sensitive the direct cost data is, it was important to gain the support of participants during the first phase of the study. An invitation to participate in the second phase, together with the survey link, was emailed to all 14 participants. Participants were given two weeks to complete the questionnaire. The first email solicited one response. Ten days after the first

survey email, a reminder email was sent to participants who had partially completed the questionnaire and to those participants who had not yet responded. Sending out a reminder email yielded three more responses. The researcher continued to follow up with participants who had not yet responded and by the end of the data collection period, a total of six responses were received. Five participants completed the questionnaire for three business rescue cases, while one participant completed the questionnaire for one business rescue case. As a result, 19 business rescue cases were incorporated into the study.

### 2.3.3.3 Measures

Table 6 provides a description of all the variables measured in the quantitative phase of the study.

**Table 6: Measures**

Variable	Description
Company size	Company size was measured as the total asset value at the commencement date of business rescue proceedings. This measure for company size is in line with several international studies that typically relate direct costs as a percentage of the company's assets (LoPucki & Doherty, 2004:123; Lubben, 2000:512).
Duration	Duration was measured as the number of months the company spent in business rescue proceedings.
Total direct cost	<p>The quantitative phase of the study measured the direct cost categories and components that was presented in Figure 2 that was developed from the first qualitative phase findings. The following categories were included in the measure of the total direct costs:</p> <ul style="list-style-type: none"> <li>• The basic remuneration of the BRP.</li> <li>• Professional fee disbursements (S143(1)).</li> <li>• General disbursements (S143(1)).</li> <li>• Contingency fees (success-based fees) (S143(2)).</li> </ul> <p>It must be noted that there are often costs that a BRP is required to incur during business rescue, however, these costs are often paid directly by the company and are treated as normal operating expenses or treated as costs that are incurred in the "ordinary course" of business. As a result, such fees may not be reflected in the BRPs' records and are therefore not included in this study. This study also does not include costs incurred by other parties, such as creditors.</p>
Demographic variables	The questionnaire contained questions to determine the company's industry and company type. Companies in the sample were classified according to the Standard Industrial Classification codes.

### **2.3.4 Ethical considerations**

The Research Ethics Committee of the Faculty of Economic and Management Sciences at the University of Pretoria approved the study in November 2017. Participant's informed consent to take part in the study was obtained before the start of the interview, as per the guidelines set out by the University of Pretoria (see Appendix A). In addition, each participant was required to read and sign the informed consent form before the completion of the questionnaire (see Appendix B).

The consent forms ensured that participants were provided with information regarding the purpose of the study, who the researcher is, and how the data will be used. Participants were given pseudonyms to remove any information that could be linked to the participants (i.e., participant and company names). As a result, participants were ensured the right of confidentiality and anonymity to prevent any harm against the participants or their company. Due to the sensitive nature of the direct costs data, participants who completed the survey were not required to disclose the names of the companies.

## **2.4 FINDINGS**

### **2.4.1 Phase one: qualitative findings**

A popular placements matrix showing the percentage of participants who sorted each direct cost component into the corresponding category is displayed in Table 7. All participants interviewed supported all four direct cost categories as categories to classify the direct costs incurred to the BRP during business rescue proceedings. Each category consists of various components and is expounded on in detail below. The first row displays the four direct cost categories while the first column displays the direct cost components.

**Table 7: Final popular placements matrix**

<b>Direct cost components</b>	<b>C1</b>	<b>C2</b>	<b>C3</b>	<b>C4</b>	<b>C5</b>
Planning, preparation and assessments completed or undertaken by the BRP	100%				
Compilation of the business rescue plan	100%				
Time spent managing the company as BRP	100%				
BRP consulting with professionals	100%				
BRP consulting with the company	100%				
BRP consulting with affected parties	100%				
Co-appointed BRP's	93%	7%			
Travelling time	93%				7%
Filing for business rescue proceedings (e.g. submitting documentation to CIPC, etc.)	70%				30%
Legal fees (Attorney's, advocates, etc.)		93%	7%		
Expert and advisory services		93%	7%		
Liquidators (e.g. determining the liquidation value)		86%			14%
Valuators		79%	21%		
Accountants		79%	7%		14%
Auditors		71%			29%
Bookkeepers		57%	36%		7%
Auctioneers and estate agents		57%	43%		
Travelling expenses			100%		
Professional indemnity insurance		14%	79%		7%
Administrative services (Admin clerk, etc.)		36%	64%		
Administrative expenses (photocopies, telephone calls, faxes, etc.)			57%		43%
Success fee based on performance after business rescue				100%	
Fee payable on the substantial implementation of the business rescue plan				93%	7%
Fee payable on the adoption of the business rescue plan				79%	21%

<b>Direct cost components</b>	<b>C1</b>	<b>C2</b>	<b>C3</b>	<b>C4</b>	<b>C5</b>
BRP commission on returns to creditors				80%	20%
BRP commission on the sale of the business as a going concern				71%	29%
Success fee in the form of shares after business rescue				67%	33%
BRP commission on the sale of immovable property				57%	43%
BRP commission on the sale of movable property				50%	50%
BRP commission on discounts negotiated on behalf of the company				14%	86%
BRP commission on the raising of post-commencement finance				43%	57%
BRP commission on the sale of members interests and shares				43%	57%

Notes:

C1: Basic remuneration of the BRP (S143(1)).

C2: Professional fee disbursements (S143(1)).

C3: General disbursements (S143(1)).

C4: Contingency fees (success-based fees) (S143(2)).

C5: Not applicable.

### **2.4.1.1 Basic remuneration of the BRP**

The second column, the basic remuneration of the BRP, shows that there is a high level of agreement between participants on what the BRP may charge an hourly fee for. All participants agree that BRPs may charge companies for the first six components presented in Table 7. Ninety-three per cent of participants indicated that it is fair and common practice, in terms of professional standards, to charge the company the hourly rate for the time spent travelling. The time spent travelling could have been used productively in other cases, therefore, a BRP should be compensated for that time. In contrast, seven per cent of participants do not charge a fee for the time spent travelling.

Filing for business rescue proceedings can either be done by the company and its legal advisors, professionals who specialise in filing for proceedings, or by the BRP. In a case where the BRP files for proceedings, 70% of participants indicated that the process of filing would be included as part of the basic remuneration of the BRP. In contrast, 30% of participants do not charge a company for filing for proceedings. One participant highlighted that some BRPs charge substantial once-off fees in order to file for business rescue on behalf of the company. The rationale behind this practice is that it shows the company's commitment and financial ability to save the company. The following quote highlights the rationale behind charging a fee for filing for business rescue proceedings:

“...we also charge a fee for doing that and I think all practitioners should do that because it immediately shows the clients willingness to save the company. If it's free, everyone's going to do it and if you ask a fee for it, it shows commitment by the client, because he is willing to pay money to make this thing work.” (BRP13)

Participants voiced several issues with the hourly tariff prescribed in the Regulations of the Act. Firstly, the hourly rate is too low considering the professional associated risks that come with the BRP profession. Secondly, participants indicated that the hourly rate is dependent on the Public Interest Score of the company but does not consider the complexity that may come with each case. Lastly, participants believe that the prescribed hourly rate is not commensurate to the experience and seniority of some BRPs. As a result, the hourly rate is not necessarily large enough to attract competent and highly skilled professionals to the profession. For this reason, it is justifiable to adjust the hourly rate appropriately as some



BRPs have the ability to earn a larger hourly fee in their other professions. The following quote highlights the fact that the hourly rate BRP's may charge may be too low:

"If I get appointed in a company with a PI score below a 100. Purely in accordance with the Act, I'm expected to work for R 1250 including VAT. My hourly rate as an attorney, is double that. Why would I do business rescue? It's just not worth it because I have got the same number of hours in a day. So, if I don't have the incentive of a contingency fee, I would never take an appointment in a small or medium sized company, if I have to stick to the fees as currently prescribed by the regulations in the Act." (BRP04)

Twelve participants indicated that their fees are adjusted using contingency fees (discussed below) or are adjusted for inflation. BRPs typically increase their fees by approximately 6% each year. It is important to note that BRPs only increase their fees with the approval of creditors and shareholders.

Another concern regarding the hourly fees is the risk of not receiving payment in the event that proceedings are converted into liquidation. This concern is heightened by the fact that there is a large amount of uncertainty around the ranking of the BRP fees. Therefore, it is common practice for BRPs to request an upfront deposit before proceedings commence which is placed in an attorney's trust account. The nature of the deposit varies; however, common practice is to charge the company a deposit that covers the costs up to the first meeting of the creditors. The purpose of the deposit is to ensure that, if the proceedings are unsuccessful, there are funds available to pay the BRP for their fees and disbursements and ensure that there are funds available to place the company into liquidation. This is in line with the guidelines set out by the Turnaround Management Association (2015a:5). Participants emphasised that the ability of the company to pay an upfront deposit is an indication of whether a company can afford proceedings. If a company is unable to pay a deposit, it would be unwise for a BRP to take on the appointment.

#### **2.4.1.2 Professional fee disbursements (S143(1))**

The types of professionals required during business rescue proceedings depend on the complexity of the case and the extent of the issues present. If the company has good employees, certain professionals are often not required as the BRP can make use of internal

employees to perform specific functions during proceedings. In this instance, the costs of these professionals are part of the normal operating expenses of the company. Some professionals play a significant role in the compilation of the business rescue plan. Therefore, the costs of these professionals will fall part of the direct costs of business rescue. The following sections express the participants' views regarding the professional fees typically incurred during proceedings:

- ***Legal fees***

In line with the findings of Pretorius (2015), legal fees are the biggest professional fee disbursement during proceedings and are incurred frequently, especially in large business rescue cases. The magnitude of legal fees is seen in the following quote:

“In every rescue you need an attorney and advocate on board sometimes. Mainly because, well it's getting better, but creditors don't understand how rescue works. So, you get lots of noise, [for example] “but I've got reservation of ownership” when it doesn't apply, and you've got to investigate each one carefully. So legal fees are probably the biggest professional fee disbursement.” (BRP10)

During proceedings, a company may incur legal fees for various reasons. Firstly, BRPs need an attorney to protect their interests during the entire process. Secondly, an attorney may be needed to review the business rescue plan before it is published as it is a legally binding document. Thirdly, several disputes may arise with affected parties and those disputes may need to be resolved legally. Participants indicated that disputes often arise with creditors as some creditors may not understand the business rescue process. Section 136 of the Act allows the BRP to suspend parts of contracts, therefore, legal services may be required to renegotiate those agreements. Lastly, BRPs may need to enlist the services of labour lawyers if retrenchments are part of the plan, as is often the case in some turnaround situations (Trahms, Ndofor & Sirmon, 2013:1294).

- ***Accountants, auditors and bookkeepers***

According to participants, these professionals are typically already employed by the company and these costs are part of the normal operating expenses of the company. Depending on how good the company's own staff are, the BRP might bring in their own staff or third parties to support the business rescue. These professionals are often required to

prepare amortisation schedules, repayment schedules, three-year cash flow statements, and balance sheets. In some instances, a third party would be required to get the accounting records up to date and to ensure a company's tax compliance is in order. It may be necessary to enlist the services of these professionals to evaluate the data integrity of the company's financial statements. These services are important for the compilation of the business rescue plan, therefore, their fee would be part of the costs of business rescue and not the normal operating expenses of the company. Participants emphasised that BRPs are qualified to perform these functions, but it is often cheaper for these professionals to perform these functions while the BRP focuses on the business rescue effort.

- ***Auctioneers and estate agents***

The services of auctioneers and estate agents are required in instances where the BRP would need to dispose of movable and immovable assets. According to participants, the likelihood of the BRP being able to dispose of assets effectively within the business rescue environment is quite small, therefore, auctioneers and estate agents would be required.

- ***Valuators***

Participants indicated that the services of a valuator are important during business rescue, especially for the compilation of the business rescue plan. The Act requires the BRP to calculate the probable dividend that creditors would receive should the company immediately liquidate (i.e., liquidation scenario). An independent valuation of the company's assets is important for the BRP to calculate an objective and unbiased value.

Moreover, the Act provides for the BRP to sell assets within the business rescue environment, therefore, an independent valuation of the assets is important to ensure BRPs sell assets at a fair value. The valuation provides a benchmark against which the BRP sells assets. Participants stressed that a BRP leaves themselves open to attack if they do not get an independent valuation of the assets, therefore, it protects the BRP.

- ***Liquidators***

According to 86% of participants, the services of a liquidator, or an independent body, is very important to determine the liquidation valuation during business rescue. Some

participants enlist the services of a professional to determine the liquidation scenario in order to ensure the value is not influenced by their biases. These participants stressed that an independent valuation is important to protect themselves from creditors. The importance of an independent liquidation valuation is highlighted by the following quote:

“Always! Always independently. As a practitioner I shouldn’t be doing it at all. What if my views are biased by the way I want the plan to be. I can’t do that, so I have it independently done.” (BRP03)

Other participants believe that an independent valuation of the liquidation scenario is only required in large and complex cases. In contrast, 14% of participants believe an independent valuation of the liquidation valuation is not required and therefore, calculate the value themselves. An interesting finding is that some participants believe it is a requirement set out in the Act, while other participants do not believe that it is a requirement.

- ***Experts and advisory services***

Participants indicated that it is often important to enlist the services of experts and advisors during business rescue, as a BRP is not an expert in all business fields. Typical experts required during proceedings may include, but are not limited to, engineers, mining specialists, tax specialists (if there is a tax implication for a unique situation), corporate governance specialists, and retail experts.

#### **2.4.1.3 General disbursements (S143(1))**

Regulation 128(3) states that a BRP is entitled to be reimbursed for the actual cost of any disbursements made by the BRP, or expenses incurred by the BRP to the extent reasonably necessary to carry out the BRP’s functions and facilitate the conduct of the company’s business rescue proceedings. According to participants, BRPs may recover the following expenses and disbursements:

- ***Travelling expenses***

All participants agree that BRPs are entitled to recover travelling expenses. BRPs may charge a fee per kilometre travelled if the BRP’s own vehicle is used. Participants typically

calculate a fee using the Automobile Association tariffs as a guideline. Travelling expenses may include toll fees, parking fees, vehicle hire, accommodation, meals, and refreshments.

- ***Professional indemnity insurance***

Ninety-three per cent of participants recover the costs of professional indemnity insurance from the companies during business rescue. In most instances, BRPs take out professional indemnity insurance on an individual case basis to get coverage that is specific to the needs of the company. In other instances, BRPs have blanket insurance and charge the company a flat fee. Seven per cent of participants have blanket insurance, however, these participants cover this cost as a normal operating expense of their company.

- ***Administrative expenses and services***

Administrative expenses include charging the company for the costs of photocopies, telephone calls and faxes, for example. Fifty-seven per cent of participants agree to charge a company for administrative expenses, as a BRP is entitled to recover these costs. In contrast, 43% of participants do not recover these costs from the company, as they believe these costs are insignificant compared to other costs.

All participants recover the costs of administrative services from companies during business rescue. Administrative personnel are typically part of the BRP's team and perform mundane tasks, allowing the BRP to focus on the business rescue effort. Administrative services are typically charged at a lower hourly rate than a BRPs rate, therefore, it is beneficial for the company in terms of saving costs. One participant emphasised the importance of having administrative personnel as part of the team in order to stick to timelines and ensure that there is continuous communication with creditors.

#### **2.4.1.4 *Contingency fees (success-based fees) (S143(2))***

Section 143(2) of the Act allows for a BRP to propose an agreement with the company providing for further remuneration to be calculated on a contingent basis. According to the Act, contingency fees may become payable upon the adoption of the business rescue plan at all, or within a particular time, or the inclusion of any particular matter within such a plan; or on the attainment of any result or a combination of results relating to the business rescue

proceedings. Contingency fees charged vary substantially from case to case. Whether the contingency fees are appropriate or not depends on the circumstances.

According to participants, the hourly rate prescribed in the Act is not sufficient to make accepting business rescue appointments worthwhile, especially for highly skilled professionals. Therefore, contingency fees are very important as BRPs often use contingency fees to increase their hourly rate. Some participants indicated that if they do not have the incentive of a contingency fee, they may never take an appointment in a small or medium company. Participants increase their hourly rate on certain milestones during proceedings. The milestones mentioned include the Section 143 meeting to approve the remuneration agreement, the adoption of the business rescue plan or the substantial implementation of the plan. Participants indicated that BRPs typically increase or double their hourly rate on certain milestones and may also apply the increase in retrospect. The following sections express the participants' view regarding contingency fees charged during proceedings:

- ***Fee payable on the adoption of the business rescue plan***

Seventy-nine per cent of participants agree that charging a contingency fee on the adoption of the business rescue plan is fair. Participants agree with this fee as the Act refers to the adoption of the business rescue plan as a criterion for a contingency fee. However, participants indicated that this fee is appropriate, provided that the requirements for substantial implementation are adequately set out in the business rescue plan. This fee is typically negotiated and BRPs typically charge a lump sum fee or charge a premium against the hours spent on the business rescue up until that point. The premium is typically charged against the hours going forward, in other words, the BRP negotiates an increased hourly rate.

In contrast, 21% of participants do not agree with charging this contingency fee for several reasons. Firstly, one participant believes that the BRPs function during proceedings is to draw up a plan and ultimately get creditors to vote the plan in. As a result, the BRP should not receive additional remuneration above the hourly rate for performing their basic function as a BRP. Secondly, another participant indicated that this fee may create a conflict of interest as the BRP may accept unreasonable demands, made by creditors, to get the plan

voted in. This may affect the successful implementation of the plan. Lastly, participants indicated that, with this fee, there is a perception that the BRP may push to get the plan adopted, receive the payment, and then leave the project.

- ***Fee payable on the substantial implementation of the business rescue plan***

Ninety-three per cent of participants agree that a BRP is entitled to charge a contingency fee on the substantial implementation of the business rescue plan. Participants indicated that this fee incentivises BRPs to not unduly drag out proceedings. Participants agree with this fee as the BRP is only remunerated once the business rescue is complete and the plan is fully implemented. Participants indicated that they prefer a fee on the substantial implementation of the business rescue plan over the adoption of the business rescue plan. With this fee, participants believe that the BRP is motivated to implement the business rescue plan more effectively and is not motivated to just have the plan adopted. This fee is negotiated and BRPs typically charge a lump sum fee or charge a premium on the total hours spent on the rescue.

- ***BRP commission on the sale of the business as a going concern***

Seventy-one per cent of participants agree that the BRP is entitled to charge a commission on the sale of the business as a going concern. In contrast, 29% of participants do not agree with charging this fee. These participants indicated that the sale of a business as a going concern is part of the BRPs function and therefore a BRP should not be remunerated for it. One participant believes that under certain circumstances, this fee may be acceptable. However, the BRP should only receive a commission once a minimum threshold, in terms of the sale price, has been achieved.

- ***BRP commission on the sale of movable and immovable property***

When it comes to the sale of assets during business rescue proceedings, 50% of participants agree with charging a commission on the sale of movable assets. While 57% of participants agree with charging a commission on the sale of immovable assets. These participants only agree to this charging of a fee on the sale of movable or immovable assets insofar as the BRP is responsible for the disposal of the assets. If the BRP appoints professionals, there

is no basis for a BRP to receive a commission as the professional is also receiving a commission.

Participants indicated that this fee may be acceptable, and even advantageous, in a wind-down scenario. This is in line with the remuneration guidelines set out by the Turnaround Management Association (2015a:3). In a wind-down scenario, the company may not have sufficient cash available to pay the BRP and therefore the BRP can receive remuneration in the form of commission on asset sales. This type of remuneration agreement provides the BRP with the incentive to sell the assets at the best possible price. If the BRP is not receiving an hourly rate, there is no incentive to unduly drag the proceedings out. Another participant noted that if a BRP is able to dispose of assets at market-related rates and charges a lower commission than professionals, then this fee may be advantageous for the company. This is illustrated by the following quote:

“...we normally only do that when we are winding a company down in business rescue...So, if it’s just an ongoing business and we are selling a property, then it’s less acceptable to charge a commission on the sale of immovable property but if you are winding the company down or partially winding it down then absolutely.” (BRP12)

In contrast, 50% of participants do not agree with charging a commission on the sale of movable property and 43% of participants do not agree with charging a commission on the sale of immovable property. These participants believe that this commission may motivate the BRP to sell more assets than necessary. Participants believe that a BRP should enlist the services of professionals who are experts in disposing of assets to get the best possible value. In this instance, BRPs should not receive a commission.

- ***BRP commission on returns to creditors***

Eighty per cent of participants agree that a BRP may charge a contingency fee linked to the percentage of dividends paid to creditors. This fee is typically calculated as a percentage of the difference between the liquidation dividend and the business rescue dividend presented in the business rescue plan. Participants agree with this fee as it links the BRPs remuneration to creditor’s dividends, therefore, for the BRP to receive the remuneration, creditors must be paid. Furthermore, participants view this fee as an incentive to a BRP to



do their best to receive the highest value for the creditors. Creditors typically do not object to this contingency fee.

- ***Success fee based on performance after business rescue***

Participants agree that a BRP may receive remuneration based on the performance of the company after proceedings have been concluded, as a contingency fee. Participants agree with this fee, as it is a good indication of how well the BRP executed proceedings. This fee may be calculated as a percentage of profits. However, one participant stated that this fee should only be payable to the extent that the company's profits exceed the projected value.

- ***Success fee in the form of shares after business rescue***

Sixty-seven per cent of participants agree that a BRP may be entitled to become a shareholder of the company, once proceedings have ended, as a contingency fee. This fee may entail the BRP receiving shares, after proceedings, provided the share price exceeds a projected target. This fee may also be acceptable in the case where the company does not have the cash available to pay the BRP's remuneration.

In contrast, 33% of participants believe that receiving shares, even after proceedings have been concluded, still creates a conflict of interest and an independence issue. This is because the BRP will be motivated to reduce the debt in the company, whereas the purpose of business rescue is to optimise the recovery for the creditors.

- ***BRP commission on the raising of post-commencement finance***

Fifty-seven per cent of participants believe a BRP is not entitled to charge a fee on the raising of PCF during business rescue proceedings. Participants disagree with this fee for several reasons. Firstly, it is argued that the task of raising PCF falls within a BRPs functions and therefore, the BRP should not receive further remuneration beyond the hourly rate. Secondly, PCF already comes at a high cost, therefore, BRPs should not receive a commission on top of it. Thirdly, one participant noted that if a BRP receives compensation for raising PCF, there is no incentive to reduce the costs that come with raising PCF. Lastly, one participant argued that receiving this fee may motivate BRPs to raise PCF from parties

such as loan sharks. The following quote highlights the issue with charging a commission on the raising of PCF:

“...let’s say it’s a nice commission on funding, who are the funders out there? You have got a lot of loan sharks, not banks. Will the banks lend money to business rescue? No! Who’s going to lend the money to business rescue? The loan sharks. You borrow money from the loan sharks, you pocket the commission, you put in the substantial implementation, you walk away, and who has got the problem? The company has got the problem.” (BRP09)

In contrast, 43% of participants agree with charging a fee on the raising of PCF. According to these participants, raising PCF is a very challenging task and provided that the PCF is raised from an external party, the BRP should be entitled to receive this fee.

- ***BRP commission on the sale of members interest and shares***

Fifty-seven per cent of participants believe a BRP should not be able to charge a commission on the sale of the company’s interests or shares. Participants indicated that if the BRP sells shares of the company during business rescue, that it should be a separate arrangement between the sellers and the BRP. This arrangement should not be part of the business rescue proceedings.

In contrast, the sale of shares during proceedings may be acceptable in certain circumstances and in these instances, a BRP may be entitled to a commission. However, participants indicated that it may be acceptable if the sale of shares is part of the absolute strategy of the business rescue or in the context of the sale of the business. One participant indicated that a BRP should not receive this fee as the BRP may be motivated to increase the value of the shares by reducing the recovery by creditors in order to receive a larger commission.

- ***BRP commission on discounts negotiated on behalf of the company***

Eighty-six per cent of participants do not agree that a BRP should charge a contingency fee on the discounts negotiated on behalf of the company. Participants believe that charging this fee may incentivise the BRP not to act in the best interests of the creditors and therefore by charging this fee, the BRP may prejudice creditors. Participants indicated that negotiating

discounts is part of the BRPs function and therefore, the BRP should not receive remuneration beyond the hourly rate.

#### **2.4.2 Phase two: quantitative findings**

The main purpose of the quantitative phase was to measure the direct costs and direct cost components identified in the qualitative phase of the study for companies that were previously under business rescue in South Africa. Moreover, the quantitative phase sought to investigate the relationship between the direct costs of business rescue and the following variables: company size, and duration of business rescue proceedings.

It must be noted that a sample size of 19 companies is by no means sufficient to generalise the findings to the larger population. By conducting the second phase, the researcher hopes to initiate further exploration into the topic. The sample size for the second phase was small for several reasons. The researcher only asked participants who were interviewed in the first phase to complete the questionnaire in the second phase. This is because, given how sensitive the direct cost data is, it was important to gain the support of participants during the first qualitative phase. Given the time and cost constraints, the researcher was not able to reach a larger sample of participants. Eight out of the 14 participants declined to participate in the second phase due to the sensitivity of the cost data or because participants did not have the time.

##### **2.4.2.1 *Descriptive statistics***

Descriptive statistics of the sample companies are presented in Table 8. The average company size, defined as total asset value at the commencement date, is R 125 084 211. There is a great deal of variation in the present sample as company size ranges from a minimum of R 2 000 000 to a maximum of R 662 000 000. Direct costs range from R 450 000 to R28 531 000, the mean level is R 4 206 824. Total direct business rescue costs average 3.36% of the total asset value. Figure 7 (see Appendix D) displays direct costs as a percentage of total asset value (%DC/TA) for all 19 companies in the study. The %DC/TA ranges from a minimum of 0.81% to a maximum of 92.62%, with a mean ratio of 14.27%.

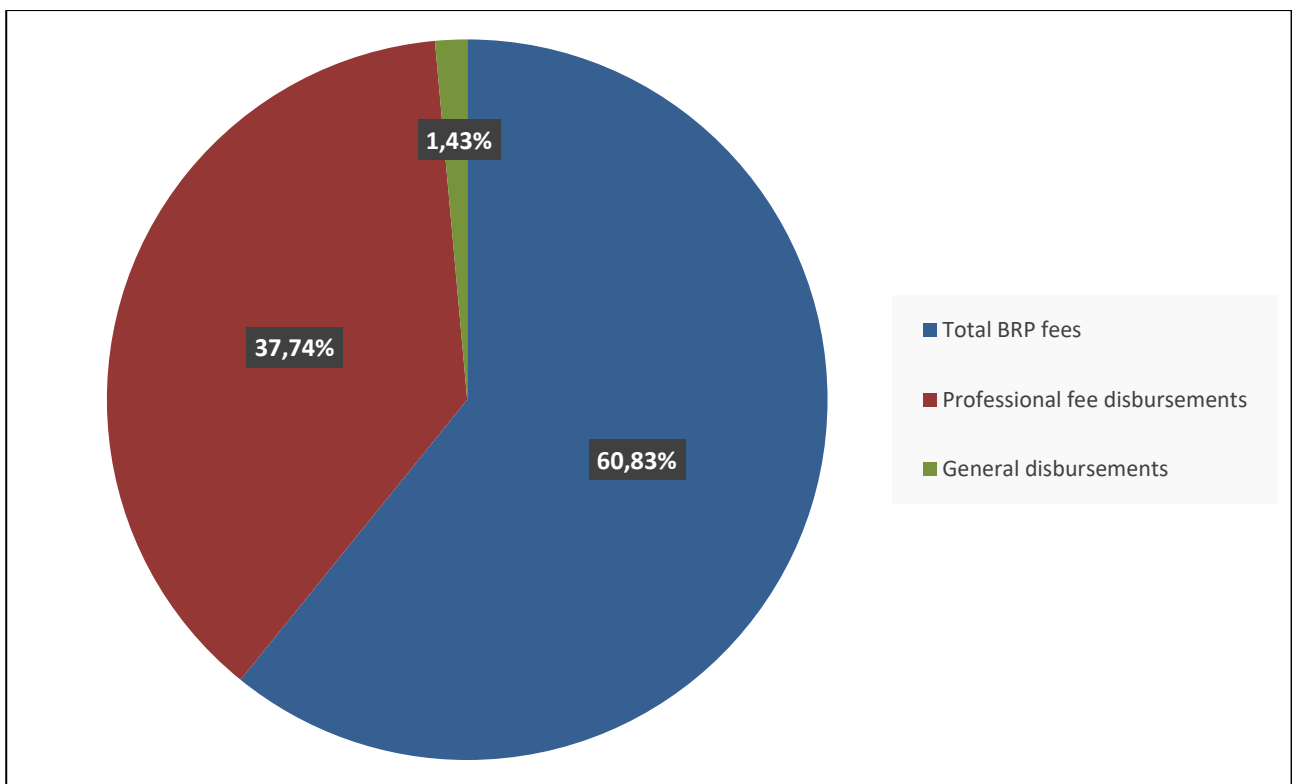
**Table 8: Descriptive statistics (n = 19)**

	<i>Minimum</i>	<i>Maximum</i>	<i>M</i>	<i>SD</i>
Company size (total assets) (R)	2 000 000	662 000 000	125 084 211	200 655 891.92
Duration (months)	7	40	17.53	10.34
Direct costs (R)	450 000	28 531 000	4 206 842	6 763 869

Notes: *M* = Mean, *SD* = Standard deviation.

Figure 1 provides a breakdown of the total direct cost for all 19 companies.

**Figure 1: Breakdown of the total direct costs for all 19 companies**



Of the total direct cost, the total BRP fees made up 60.83%. The total BRP fees consisted of the BRPs basic remuneration and contingency fees. The second largest component of the direct costs were the professional fees, which made up 37.74% of the total direct cost. Of the total professional fees, 30.60% consisted of legal fees, while fees paid to other professionals only made up 7.14% of the total direct cost. Lastly, general disbursements consisted of 1.43% of the total direct cost.

The total BRP fees consisted of the basic remuneration of the BRP and contingency fees (success-based fees) (143(2)). The main reason for this is that, in some cases, the participants could not distinguish the difference between the two categories as contingency fees are often used to increase the BRPs basic remuneration. As a result, the researcher combined the two categories.

Table 9 displays the descriptive statistics for the total BRP fees. Total BRP fees range from a minimum of R 310 000 to a maximum of R 15 100 000 with a mean of R 2 559 158.

**Table 9: Descriptive statistics for total BRP fees**

	<i>n</i>	<i>Minimum</i>	<i>Maximum</i>	<i>M</i>	<i>SD</i>
Total BRP fees	19	310 000	15 100 000	2 559 158	3 542 248

Notes: *M* = Mean, *SD* = Standard deviation.

Table 10 displays the descriptive statistics for the professional fees disbursements.

**Table 10: Descriptive statistics for professional fees disbursements (S143(1))**

	<i>n</i>	<i>Minimum</i>	<i>Maximum</i>	<i>M</i>	<i>SD</i>
Legal fees	16	15 000	12 571 000	1 528 875	3 286 819
Bookkeepers, accountants and auditors	8	25 000	732 000	217 750	238 397
Auctioneers and estate agents	2	60 000	292 000	176 000	164 049
Valuators	10	10 000	160 000	59 100	53 673
Liquidators	2	99 000	125 000	112 000	18 385
Expert and advisory services	9	21 000	993 000	310 667	330 425

Notes: *M* = Mean, *SD* = Standard deviation.

Table 10 displays that legal fees are the most widely used professionals in business rescue. A total of 16 out of 19 cases incurred legal fees. Legal fees range from R 15 000 to R 12 571 000 (*M* = R 1 528 875). Valuators appear to be the second most frequently used professionals in the sample (*n* = 10), with fees ranging from a minimum of R 10 000 to a maximum of R 160 000 (*M* = R 59 100). Expert and advisory services (*n* = 9) fees range from R 21 000 to R 993 000, with a mean of R 310 667. This is followed by bookkeepers, accountant and auditors' fees (*n* = 8) which range from a minimum of R 25 000 to a

maximum of R 732 000, ( $M = R 217 750$ ). It appears that the professionals used the least during proceedings are auctioneers and estate agents ( $n = 2$ ) and liquidators ( $n = 2$ ). The fees of the auctioneers and estate agents ranged from R 60 000 to R 292 000 with a mean of R 176 000, while the fees of liquidators ranged from R 99 000 to R 125 000 with a mean of R112 000.

Table 11 displays the descriptive statistics for the general disbursements (S143(1)).

**Table 11: Descriptive statistics for general disbursements (S143(1))**

	<i>n</i>	<i>Minimum</i>	<i>Maximum</i>	<i>M</i>	<i>SD</i>
Travelling expenses	9	10 000	80 000	35 111	22 910
Professional indemnity insurance	12	12 000	223 000	44 833	58 675
Administrative expenses and services	5	15 000	150 000	57 000	58 481

Notes: *M* = Mean, *SD* = Standard deviation.

Table 11 displays that professional indemnity insurance is the most widely incurred general disbursement in the sample. A total of 12 out of 19 companies incurred the cost of professional indemnity insurance. The cost of professional indemnity insurance ranges from R 12 000 to R 223 000 ( $M = R 44 833$ ). Travelling expenses appear to be the second most frequently incurred cost in the sample ( $n = 9$ ) with expenses ranging from a minimum of R 10 000 to a maximum of R 80 000 ( $M = R 35 111$ ). The cost of administrative expenses and services ( $n = 5$ ) fees range from R 15 000 to R 150 000, with a mean of R 57 000.

#### **2.4.2.2 Hypotheses tests**

Hypotheses  $H_1$  and  $H_2$  deal with the correlation between a) company size and direct costs and b) duration and direct costs respectively. The relevant null and alternative hypotheses are stated below:

$H_{1(\text{null})}$ : There is no relationship between company size and the direct costs of business rescue.

$H_{1(\text{alt})}$ : There is a significant relationship between company size and the direct costs of business rescue.

$H_{2(\text{null})}$ : There is no relationship between duration and the direct costs of business rescue.

$H_{2(\text{alt})}$ : There is a significant relationship between duration and the direct costs of business rescue.

The above-mentioned hypotheses are both two-tailed (non-directional) hypotheses and were tested at a 5% level of significance (i.e.,  $\alpha = 0.05$ ). As all the variables mentioned above were measured at a ratio level of measurement, the appropriate parametric significance test is Pearson's product moment correlation. According to Pallant (2007:124), this test assumes that there is a linear relationship between each pair of variables being correlated and that both variables have a normal distribution. If the assumptions cannot be met, a non-parametric substitute, known as the Spearman's rank order correlation, can be used (Field, 2009:179).

For each pair of variables, the assumption of normality was assessed through the Kolmogorov-Smirnov test, in conjunction with a visual perusal of histograms and normal probability plots, while the assumption of linearity was tested through the visual inspection of a scatter plot (see Appendix E) (Field, 2009:144). For all three variables, the results of the Kolmogorov-Smirnov test indicate that the assumption of normality was violated. The scatter plots indicate that the assumption of linearity was not violated. The non-parametric Spearman's rank order correlation was, therefore, used to test  $H_1$  and  $H_2$ . According to Diamantopoulos and Schlegelmilch (2000:67), non-parametric statistics is appropriate with small sizes, typically with sample sizes of less than 30.

Table 12 is a correlation matrix displaying the results of the two correlation analyses.

**Table 12: A correlation matrix displaying the results of the Spearman's rank order correlation for H<sub>1</sub> and H<sub>2</sub>**

		<b>Total: direct costs</b>
<b>Total: company size (total assets)</b>	Correlation Coefficient	0.662**
	Sig. (2-tailed)	0.002
	N	19
<b>Total: duration (months)</b>	Correlation Coefficient	-0.212
	Sig. (2-tailed)	0.384
	N	19

Notes: \*\* Correlation is significant at the 0.01 level (2-tailed).

The results in Table 12 indicate that there is a statistically significant, positive correlation between company size and direct costs,  $r_s(17) = 0.662$ ,  $p = 0.002$ . The coefficient of determination,  $r^2$ , indicates that the two variables share 43.8% common variance. This implies that only 43.8% of the variance in one variable is explained by the variance in the other. Adams and Lawrence (2015:234) describe this as a strong correlation as the correlation coefficient is larger than 0.5. In summary,  $H_{1(null)}$  was rejected in support of  $H_{1(alt)}$ . This suggests that there is a significant positive relationship between company size and direct costs.

The correlation between direct costs and duration is not statistically significant,  $r_s(17) = -0.212$ ,  $p = 0.384$ .  $H_{2(null)}$  can, therefore, not be rejected in favour of the stated alternative hypothesis,  $H_{2(alt)}$ . The findings thus suggest that there is no relationship between duration and direct costs.

According to Pallant (2007:121), outliers can have a dramatic effect on the correlation coefficient, especially in small samples and recommends removing outliers to reduce the effect it has on the correlation coefficient. Upon inspection of the scatter plot showing the correlation between company size and total direct costs (Figure 11, Appendix E), it appears that outliers are present (cases 8, 9, 11 and 12). In addition, the scatter plot showing the correlation between duration and total direct costs (Figure 13, Appendix E) also displays outliers (cases 3, 9, 11, 15 and 16).



The researcher removed the outliers and the two hypotheses were tested. It must be noted that an advantage of Spearman's rank order correlation is that outliers that were troublesome before ranking, distort the resulting coefficient less than in a Pearson correlation. This is because the largest number in the distribution is equal to the sample size (Cooper & Schindler, 2014:497; Tanner, 2012). Table 13 is the correlation matrix displaying the results of the two correlation analyses after the outliers were removed.

**Table 13: A correlation matrix displaying the results of the Spearman's rank order correlation for H<sub>1</sub> and H<sub>2</sub> where the outliers have been removed**

		<b>Total: direct costs</b>
<b>Total: company size (total assets)</b>	Correlation Coefficient	0.416
	Sig. (2-tailed)	0.123
	N	15
<b>Total: duration (months)</b>	Correlation Coefficient	-0.473
	Sig. (2-tailed)	0.088
	N	14

Table 13 indicates that the correlation between company size and direct costs is not statistically significant,  $r_s, (13) = 0.416, p = 0.123$ .  $H_{1(null)}$  is therefore not rejected. The findings thus suggest, once outliers were removed, that there is no relationship between company size and direct costs.

The findings in Table 13 show that, once outliers were removed, the correlation between duration and direct costs is not statistically significant,  $r_s, (12) = -0.473, p = 0.088$ .  $H_{2(null)}$  can, therefore, not be rejected in favour of the stated alternative hypothesis,  $H_{2(alt)}$ . The findings, therefore, suggest that there is no relationship between duration and direct costs.

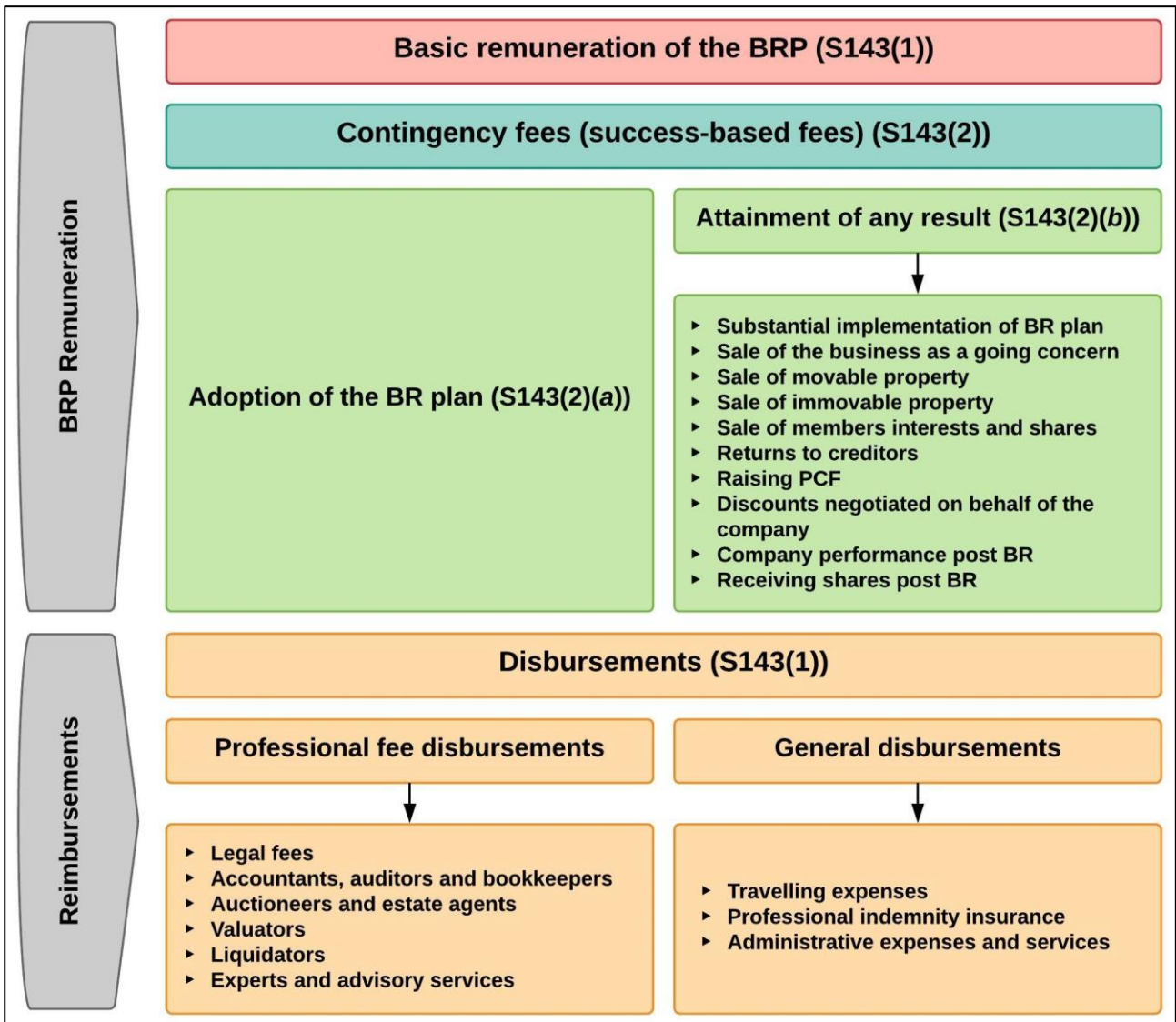
## 2.5 CONCLUSION

This study explored the direct costs of business rescue proceedings in South Africa. The study commenced by identifying the direct costs of business rescue through a qualitative exploration. The direct costs identified from the qualitative data analysis were then measured in the second quantitative phase of this study. In addition, this study examined

the relationship between the direct costs of business rescue and the variables company size and duration of business rescue proceedings.

Figure 2 presents a visual depiction of the qualitative findings of this research. Figure 2 may assist affected parties in understanding the direct costs associated with business rescue proceedings.

**Figure 2: A visualisation of the direct costs of business rescue in South Africa**



Source: Author's own compilation.

Figure 2 depicts that a BRPs remuneration consists of two categories, namely, the basic remuneration of the BRP as prescribed in Section 143(1) of the Act, and contingency fees as prescribed in Section 143(2) of the Act. In addition to the BRPs remuneration, Section

143(1) as read with Regulation 128(3) allows for a BRP to be reimbursed for the actual cost of any disbursement made by the BRP, or expenses incurred by the BRP to the extent that is reasonably necessary to carry out the BRPs functions and facilitate that conduct of the business rescue proceedings. The reimbursements consist of two categories, namely, professional fee disbursements, and general disbursements.

In summary, Figure 2 shows that the direct costs of business rescue consist of four categories:

- The basic remuneration of the BRP (S143(1)).
- Contingency fees (success-based fees) (S143(2)).
- Professional fee disbursements (S143(1)).
- General disbursements (S143(1)).

The findings reveal that total direct costs average 3.36% of the total asset value. The total BRP fees, which consisted of the basic remuneration of the BRP and contingency fees, appears to be the largest direct cost (60.83% of total direct cost). This is followed by professional fee disbursements. Consistent with the research conducted by Ferris and Lawless (2000:653) and Pretorius (2015:38), the findings of the study indicate that legal fees make up a significant portion of direct costs (30.60% of total direct cost).

Consistent with previous international research on the direct costs of reorganisation, the study's findings found that there is a significant positive relationship between company size and direct costs of business rescue (Campbell, 1997:27; LoPucki & Doherty, 2004:113). Therefore, direct costs increase with the size of the company. Larger business rescue cases are likely to be more complex, resulting in higher direct costs. However, as company size increases, the direct costs are expected to decrease as a percentage of company size. This is referred to as the scale effect (LoPucki & Doherty, 2004:113). Although the researcher did not test for the scale effect, visual inspection of the graph (see Figure 7, Appendix D) displaying the %DC/TA suggests that the scale effect may be present. This highlights the possibility of the presence of fixed cost elements in the make-up of the direct costs (Citron & Wright, 2008:75).

The findings suggest that there is no relationship between duration and direct costs of business rescue proceedings. These findings are in line with the findings of Lubben (2008:80) that indicate that the time spent in proceedings has no significant relationship with direct costs. These results are surprising given that the BRPs and professional fees are time-based, therefore, direct costs are expected to increase the longer proceedings take.

In a separate analysis, the researcher removed the outliers for both H<sub>1</sub> and H<sub>2</sub> and the two hypotheses were tested. Once outliers were removed, the findings for H<sub>1</sub> suggests that there is no relationship between company size and the direct costs of business rescue. In addition, the results for H<sub>2</sub> suggests that there is no statistically significant relationship between duration and direct costs. These contradictory findings are not surprising given the fact that that Pallant (2007:121) indicates that outliers can have a dramatic effect on the correlation coefficient, especially in small samples. Consequently, readers should be aware of the fact that these results are not conclusive and are by no means sufficient to generalise the findings to the larger population.

### **2.5.1 Managerial implications**

This research sheds some light on the nature and magnitude of the direct costs of business rescue. Understanding the size and determinants of the direct costs is important before stakeholders can find strategies to reduce these costs. Therefore, this research contributes to the management body of knowledge by providing BRPs, the management of distressed companies, and affected parties, especially creditors with a starting point into understanding the direct costs of business rescue proceedings.

### **2.5.2 Limitations and directions for future research**

The qualitative phase of this study presents three main limitations. First, the qualitative phase only considered the perspective of one stakeholder group, namely that of the BRP. Consequently, the findings only reflect a single point of view, which may be incomplete. Secondly, given how the costs of business rescue have been increasingly criticised, the responses from participants may be subjected to social desirability bias (Saunders *et al.*, 2009:327). Future research should involve other stakeholder groups, such as large creditors

or directors of companies, to attain more diverse perspectives. Lastly, although Guest *et al.* (2006:61) state that six to 12 interviews are sufficient for qualitative research, the researcher acknowledges that the number of participants interviewed in the first phase may limit the generalisability of the findings. Although the findings cannot be generalised, this study provides a starting point for future research into the direct costs of business rescue proceedings.

For the quantitative phase of the study, several limitations may be present related to the data collection method used. Given the small sample size and the fact that a non-probability sampling method was used to select business rescue cases, the results of the study cannot be generalised to a larger population on statistical grounds. Future research should be conducted on a larger sample. The fact that the cost data were collected using questionnaires, may result in several limitations. Firstly, given the sensitivity of the cost data, the responses on the questionnaire may be subject to deliberate falsification, whereby participants deliberately provide a false answer to a survey question (Zikmund, Babin, Carr & Griffin, 2010:191). Although the researcher took measures to reduce the impact of this error, there is no way to validate the responses.

Another potential shortcoming of the study is that the total direct cost of business rescue may be underrepresented for several reasons. Firstly, the fact that the researcher collected direct costs within a fixed structure using a questionnaire may result in certain incidental direct costs being excluded. Consequently, it is worthy to note that one of the major shortcomings of the study is the fact that participants were constrained by the researchers' structure of the direct costs in the questionnaire. Secondly, this study included only fees and expenses incurred by the BRP. There is the possibility that the companies incurred other kinds of expenses that are a direct result of the business rescue, and these expenses may have been paid by the companies directly. For example, a company may have paid a third party to file for proceedings, however, the BRP appointed did not incur these costs and therefore, did not invoice the company. Thirdly, this study did not include restructuring costs, for example, the costs of retrenching employees or the costs of shifting production to a new location. Lastly, this study did not include fees and expenses paid by other parties, for example, creditors.

Future research should examine the total direct cost of business rescue proceedings by collecting documents and conducting a document analysis to ensure all costs are included. This could result in identifying new direct costs components that were not identified in this study. Future research should include retrenchment costs and costs incurred to other parties other than the BRP and company. This may assist in providing a better reflection of the magnitude of the total direct cost of business rescue.

CHAPTER 1: Introduction 2

CHAPTER 2: Paper 1 10

CHAPTER 3: Paper 2 57

CHAPTER 4: Summary and conclusion 93

CHAPTER 5: List of references 101

## CHAPTER 3: PAPER 2

### TITLE: INDIRECT COSTS OF BUSINESS RESCUE: QUALITATIVE EVIDENCE FROM SOUTH AFRICA

#### ABSTRACT

**Background:** It is often argued that the indirect costs of financial distress are substantially higher than the direct costs. As a result, indirect costs of participating in a formal turnaround may hinder the success of a reorganisation attempt. However, there is a gap in turnaround literature regarding what the indirect costs of business rescue proceedings are.

**Purpose:** This study set out to explore the indirect costs that financially distressed companies face, as a consequence of participating in business rescue proceedings in South Africa. Due to the implicit nature of these costs, the focus was placed on investigating and identifying the sources of the indirect costs associated with business rescue proceedings.

**Method:** This study employed a qualitative research design. Semi-structured interviews were conducted with 13 licenced business rescue practitioners. This study made use of a combination of non-probability sampling methods, namely, purposive and snowball sampling.

**Results:** The study was able to confirm that companies in business rescue experience the following difficulties: a loss of customer and supplier goodwill, a decrease in employee morale and productivity, increased turnover of key employees and management, the inability to raise finance, and inefficient asset sales. However, there are several factors that influence the severity of these difficulties. Conversely, it appears that indirect costs may also offer companies several benefits.

**Conclusion:** The results of the study may assist stakeholders as they offer some insight and clarity as to the nature of the indirect costs of business rescue. Understanding indirect costs may assist stakeholders involved in the process to find strategies that will maximise value preservation of the company and reduce the negative impact for all stakeholders involved.



**Keywords:** *Financial distress, insolvency, reorganisation, business rescue, indirect costs, South Africa*

### 3.1 INTRODUCTION

*“Pessimism is not only unwarranted, it is also a self-fulfilling prophecy. If you think the cause is lost, it will be. No one works hard for a cause they think will lose.” – Lawrence Reed*

#### 3.1.1 Background

Companies that enter business rescue proceedings may inadvertently bring upon themselves a negative perception purely through the act of applying for business rescue. This negative perception as a “self-fulfilling prophecy” may contribute to any rescue attempt failing before it even starts. This reputational damage has the potential for a series of follow-on effects (Bhabra & Yao, 2011:46; Searle, 2013:19). The stigma associated with reorganisation procedures, such as business rescue, may cause key stakeholders to withdraw from the company. Consequently, suppliers may transact on adverse terms to reduce their risk exposure; credit facilities and overdrafts may be cancelled; customers may reduce risk by searching for alternative suppliers; and employees may fear retrenchments which may cause a loss in morale, which subsequently leads to lower productivity and increased employee turnover (Bhabra & Yao, 2011:46; Loubser, 2010a:504; Sutton & Callahan, 1987:405). These suboptimal actions by the company’s stakeholders may result in lost sales and lost opportunities for the company (Senbet & Seward, 1995:924). These costs, among others, are referred to as indirect costs of financial distress. Indirect costs are not actually paid out as expenses but rather arise in the form of lost opportunities and lost profits that result from a loss of customer and supplier goodwill, a decrease in employee morale and productivity, a loss of key employees and management, the inability to raise finance, and inefficient asset sales (Altman, 1984:1071; Andrade & Kaplan, 1998:1445; Armour *et al.*, 2012:110; Bhabra & Yao, 2011:45; Chen & Merville, 1999:277; Pulvino, 1998:940).

### **3.1.2 Problem statement**

The abovementioned indirect costs may cause an even faster deterioration of the operating performance of a company that is already in financial distress and, as a result, indirect costs may impede the success of the rescue attempt (Searle, 2013:19). It is often argued that indirect costs of financial distress are substantially higher than direct costs (Bisogno & De Luca, 2012:22; Chen & Merville, 1999:277; Hotchkiss, John, Mooradian & Thorburn, 2008:29). Understanding the indirect costs of business rescue is imperative as companies and business rescue practitioners ('BRPs') need to take these costs into account during proceedings. However, as far as could be determined, there is a gap in the South African literature regarding what the indirect costs of business rescue proceedings are. This study aimed to address this gap and assist in future research that may, as a result, materialise.

### **3.1.3 Purpose statement**

The purpose of this qualitative study was to explore the indirect costs that financially distressed companies face, as a consequence of participating in business rescue proceedings in South Africa. The focus was specifically placed on investigating and identifying the sources of indirect costs associated with business rescue.

### **3.1.4 Research questions**

This study aimed to answer the following question:

- What indirect costs do companies experience while undergoing business rescue proceedings in South Africa?

Indirect costs are unobservable in nature and are, therefore, difficult to specify and empirically measure. As a result, this study has expanded on this question by focusing on and investigating six important sources of indirect costs identified in the literature. The specific questions that were answered through this research study were extended to include:

- Do companies experience a loss of customer goodwill during business rescue?
- Do companies experience a loss of supplier goodwill during business rescue?

- Do companies experience a decrease in employee morale and productivity during business rescue?
- Do companies experience a high turnover of key employees and management during business rescue?
- Do companies face challenges in raising finance during business rescue?
- Do companies sell assets at depressed prices during business rescue?

### **3.1.5 Academic value and contributions of the study**

The study contributes to the body of knowledge regarding business rescue in a number of ways. First, there is a gap in the literature relating to the indirect costs of business rescue in South Africa. This study aimed to identify the indirect costs financially distressed companies face, as a consequence of participating in business rescue proceedings. In doing so, this research will contribute to the emerging literature on business rescue and formal turnaround. This study may also assist stakeholders to better understand the challenges (indirect costs) distressed companies face and how these challenges may affect the performance of companies during proceedings.

The remainder of this article is structured as follows: firstly, it presents a literature review on the indirect costs of financial distress, which includes a summary of the sources on the indirect costs. The second section of this article focuses on the research methodology, which discusses the qualitative research approach used in this study. Thereafter the findings are discussed. The article is concluded with a summary of the findings, managerial implications, limitations and finally, recommendations for future research are offered.

## **3.2 LITERATURE REVIEW**

Financially distressed companies have two distinct insolvency procedures to deal with distress, namely liquidation and reorganisation. Liquidation proceedings consist of stripping the company of its assets and all claims against the company are settled (White, 1989:130). In contrast, reorganisation seeks to take advantage of the reality that in many cases a company not only has substantial value as a going concern, but its going concern value

exceeds its liquidation value (Smits, 1999:86). Reorganisation procedures provide financially distressed companies with an opportunity to be rescued and avoid foreclosure, and to rather continue as commercially viable entities contributing to economic growth. The core purpose of a reorganisation is the prevention of unnecessary liquidation of companies and the consequent loss of jobs (Levenstein, 2015:278).

In South Africa, reorganisation is known as business rescue, presented in Chapter 6 of the Companies Act No. 71 of 2008 ('the Act'). Business rescue refers to proceedings which aid the rehabilitation of financially distressed companies by providing for the company's affairs, business and property to be placed under the temporary supervision of a BRP. The Act defines a company as financially distressed when it appears reasonably unlikely that the company will be able to pay their debts within six months of when their debts are due and payable, or when it appears reasonably likely that the company will become insolvent within the next six months. Once proceedings begin, the company is provided with a temporary moratorium on all claims against the company or property in the company's possession. The BRP's main task is to develop and, if accepted, implement a business rescue plan, in consultation with affected parties (Rosslyn-Smith & Pretorius, 2015:23). The business rescue plan serves to restructure the affairs of the company in order to return the company to financial stability. If that is not possible, the aim is to restructure the affairs of the company in a manner that results in a better return for creditors or shareholders than would result from the immediate liquidation of the company.

### **3.2.1 The costs of financial distress**

Reorganisation proceedings are not suitable for all financially distressed companies. In some cases, the costs of reorganisation may be prohibitive, making this process unsuitable for some companies, especially small companies (Levenstein, 2015:279). For this reason, the costs associated with insolvency proceedings play a significant role in a company's choice between liquidation and reorganisation (White, 1989:146). Literature typically divides these costs into direct and indirect costs. Direct costs can be defined as the transaction costs (the out-of-pocket expenses) that are directly related to administering insolvency proceedings (Altman & Hotchkiss, 2006:93). Direct costs include administration costs such as filing expenses and fees paid to professionals such as lawyers, accountants, business

consultants, turnaround specialists and various other professionals (Altman & Hotchkiss, 2006:93; Armour *et al.*, 2012:109; Bhabra & Yao, 2011:43).

Indirect costs of financial distress are those not actually paid out as expenses during insolvency proceedings (Armour *et al.*, 2012:110). Indirect costs are the hidden losses that are a consequence of operating a company that is unable to meet its financial obligations (Farooq & Jibrán, 2018:112; Pindado & Rodrigues, 2005:345). These costs are difficult to specify and empirically measure. As a result, indirect costs are often overlooked when considering the impact of insolvency proceedings on the company (Altman, 1984:1068; Bisogno & De Luca, 2012:22; Kwansa & Cho, 1995:342).

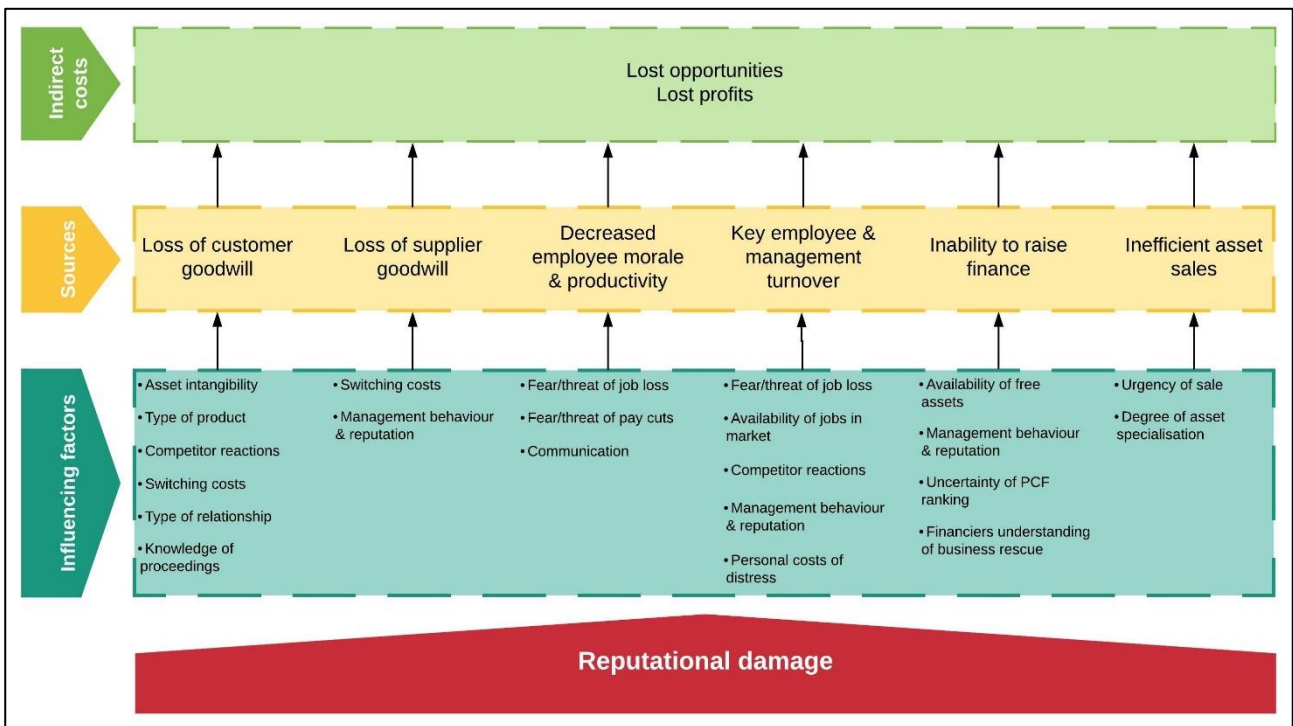
According to Farooq and Jibrán (2018:125), the literature provides a variety of definitions and proxies for the indirect costs of financial distress. The most widely studied proxies of indirect costs are lost opportunities and lost profits (Altman, 1984; Bisogno & De Luca, 2012; Kwansa & Cho, 1995; Molina & Preve, 2012; Opler & Titman, 1994; Pham & Chow, 1989; Wijantini, 2007). Lost opportunities are typically measured as the difference between industry sales growth and the company's sales growth. Similarly, lost profits are calculated as the difference between the industry's operating profit margin and the operating profit margin of the company (Farooq & Jibrán, 2018:120).

For the purposes of this study, indirect costs will be defined as lost opportunities or lost profits that result from a loss of customer and supplier goodwill, a decrease in employee morale and productivity, a loss of key employees and management, the inability to raise finance and inefficient asset sales (Altman, 1984:1071; Andrade & Kaplan, 1998:1445; Bhabra & Yao, 2011:45; Chen & Merville, 1999:277; Pulvino, 1998:940). Indirect costs are not limited to companies that file for a formal reorganisation procedure. Companies can incur indirect costs whether or not they actually file for reorganisation proceedings (Campbell, 1997:22; Chen & Merville, 1999:277). Some of these costs accrue with a company simply being in financial distress and may be amplified in formal reorganisation proceedings.

### 3.2.2 Sources of indirect costs

A visual depiction of the indirect financial distress costs based on a review of the literature is presented in Figure 3.

**Figure 3: A visual depiction of indirect financial distress costs**



Source: Author's own compilation.

The first level of Figure 3 displays the two indirect costs of financial distress most widely measured in literature, as stated by Farooq and Jibrán (2018). The second level displays the six sources of indirect costs investigated in this study. The third level displays the factors that influence the sources of indirect costs. Finally, the last level displays a major influencing factor of indirect costs, that is, the reputational damage a company suffers from entering a formal reorganisation procedure.

It can be argued that the magnitude of indirect financial distress costs is greater when a company enters a formal reorganisation procedure. When a company experiences financial distress, these issues can often be concealed from various stakeholders. However, when a company files for a formal reorganisation procedure, like business rescue, the company is required to notify affected parties. In this scenario, indirect costs may be amplified, as filing

for a formal reorganisation procedure can lead to reputational damage for a company due to the stigma associated with financial distress (Sutton & Callahan, 1987:412). Stakeholders may have negative reactions towards the company which may result in the withdrawal of their support. These negative reactions may further increase the probability of the company's failure as the success of any company depends on the continued support from its stakeholders (Searle, 2013:19; Sutton & Callahan, 1987:405). Before a company files for business rescue proceedings, there is an asymmetric availability of information amongst various stakeholders. However, when a company files for proceedings a business rescue plan is published, and private information is made available to various stakeholders and possibly the public (Rosslyn-Smith & Pretorius, 2018:89). Access to this private information may lead stakeholders to take advantage of the distressed company. The following sections expand on each source and the various influencing factors that are presented in Figure 3.

### **3.2.2.1 *Loss of customer goodwill***

One of the biggest challenges financially distressed companies face may be persuading its existing customers to continue doing business with the company. Customers may shift purchases to alternative suppliers as they may fear that product quality or that continuity of supply may be compromised (Hertzel, Li, Officer & Rodgers, 2008:375; Liou & Smith, 2007:89; Sautner & Vladimirov, 2017:1). As customers start withdrawing from the company, the company may experience a decrease in sales. The drop in demand harms the company's profitability, exacerbating its financial distress (Bisogno & De Luca, 2012:23; Hortaçsu, Matvos, Syverson & Venkataraman, 2013:1249; Sautner & Vladimirov, 2017:1).

The degree to which a company experiences a loss of customer goodwill may be influenced by several factors. It is argued that companies with high asset intangibility may experience a higher sales loss. Companies with high asset intangibility are typically vested in patents, trademarks, good reputations, and provide after-sales services. Thus, when these companies experience financial distress, their customers may also experience losses in the form of lost after-sale-services, and they also lose the products' name and reputation. Consequently, customers may be more hesitant to buy the products of a company with high asset intangibility (Bulot, Salamudin & Aziz, 2017:13). For example, car manufacturers offer goods and services that complement its core product, such as guarantees and warranties,

spare parts, maintenance, and upgrades. Customers who fear the loss of these valued amenities may be less willing to pay for the company's core product, thus, shifting purchases to competitors (Hortaçsu *et al.*, 2013:1249; Tajti, 2017:10). Knowledge of the company's financial distress may lead competitors to take advantage of the distressed company's weaknesses, by using aggressive marketing strategies to capture its market share. This is especially prevalent in concentrated industries (Farooq & Jibrán, 2018:120).

A customer's reaction to the financial distress may be influenced by the type of relationship they have with the company and by the switching costs of finding an alternative supplier. In situations where customers have an arm's length relationship with the company, with little or no switching costs, customers tend to switch to alternative suppliers to mitigate their risk. If the supplier is noncritical and goods are easily available from alternative suppliers, customers gravitate towards seeking alternative suppliers. In contrast, if the supplier is critical and the customer faces high switching costs, customers tend to support the distressed company by altering payment terms, awarding suppliers additional business volume, and even providing suppliers with an upfront payment for raw materials. Switching costs may be high in circumstances where the customer is purchasing unique products or purchasing products with few good substitutes (Banerjee, Dasgupta & Kim, 2008:2507; Bode, Hübner & Wagner, 2014:32-33; Hertzfel *et al.*, 2008:383; Lian, 2017:399).

In addition to a reduction in the company's demand, customers may also behave in ways that cause the distressed company to lose money, even for goods that were already sold. For example, customers are able to negotiate lower prices and collecting trade receivables may become more difficult and more time consuming, especially if the distressed company filed for reorganisation. Customers perceive that the filing enables them to avoid making payments. Furthermore, customers may even mark perfectly functioning equipment as defective and send these products back to the distressed company (Sutton & Callahan, 1987:416; Tajti, 2017:10).

### **3.2.2.2 Loss of supplier goodwill**

The loss of supplier goodwill is often cited as a source of indirect cost that financially distressed companies face (Hertzfel *et al.*, 2008:375; Sautner & Vladimirov, 2017:1).



Suppliers may be reluctant to continue to sell to the distressed company and, as a result, may enforce significant restrictions and higher costs on the distressed company. Suppliers may impose costs on distressed companies by failing to supply trade credit and demanding cash-on-delivery ('COD') for goods supplied (Altman, 1984:1072; Loubser, 2010a:504; Pretorius, 2015:65). The loss of trade credit may further exasperate the company's problems as trade credit is often an important source of short-term finance for distressed companies. A loss of trade credit places extended pressure on a company's immediate cash flow, which may result in lost sales and, in turn, decreased operating profit margins (Bisogno & De Luca, 2012:23; Molina & Preve, 2012:187; Pretorius, 2015:65).

There are several other difficulties distressed companies may face with suppliers. Suppliers may delay shipments, back away from entering into long-term contracts with the distressed company, remove any consignment stock from the company's property, demand immediate payment of their claims, or increase the cost of goods and services (Altman, 1984:1072; Hertz et al., 2008:375; Loubser, 2010a:504; Pretorius, 2015:65; Sutton & Callahan, 1987:417). The study conducted by Sutton and Callahan (1987:416) highlighted that once companies filed for reorganisation, the quality of goods sent from suppliers deteriorated. Suppliers began using the distressed company to clean out their "junk goods". Suppliers refused to supply goods even though they would have received COD.

Although distressed companies may experience significant difficulties with suppliers, there are several factors that may influence the degree to which they experience difficulties. Suppliers may be dependent on the distressed company in instances where suppliers face high switching costs in the event of losing the distressed company. The supplier may then grant significant concessions to the company in order to reduce the risk of failure (Lian, 2017:399; Yang et al., 2015:2320). The failure of major customers may decrease the future demands on the products and services from suppliers, which may deteriorate the supplier's future earnings and cash flows, thereby increasing the default risk of suppliers (Lian, 2017:398). Thus, a supplier's fear of losing a major sales channel may trigger a "bail-out effect" where the supplier grants concessions to the distressed company by offering trade credit and acting as liquidity providers to their important customers in distress (Oliveira, Kadapakkam & Beyhaghi, 2017:148; Yang et al., 2015:2334).

The ability to maintain supplier goodwill may be influenced by management's ability to maintain the supplier's support and management behaviour, especially in the run-up to the filing for reorganisation (Cook & Pond, 2006:28; Sutton & Callahan, 1987:412). Management may have eroded relationships with suppliers by failing to make promised payments. Thus, Sutton and Callahan (1987:406) indicate that if suppliers do not perceive management as credible, their faith in the company may be eroded.

### **3.2.2.3 *Decreased employee morale and productivity***

When a company is in financial distress, the retrenchment of employees, also referred to as downsizing, is regarded as a popular turnaround practice. This practice is undertaken primarily as a cost-cutting strategy to improve cash flows (Smith, Wright & Huo, 2008:73; Smith & Graves, 2005:307; Trevor & Nyberg, 2008:259). The allure of retrenching employees as a turnaround practice is driven by the potential to yield substantial savings in direct employment costs (Chadwick, Hunter & Walston, 2004:406). This presumption may be offset by the hidden costs associated with a decrease in employee morale and productivity, the erosion of trust between staff and management, increased absenteeism, and the unanticipated increases in voluntary turnover. It is argued that these hidden costs may well be greater than what is saved from the retrenchment (Smith & Graves, 2005:307; Trevor & Nyberg, 2008:272; Vollmann & Brazas, 1993:21).

Another cost-cutting strategy used by distressed companies is cutting employees' pay in order to save jobs. However, employees resent pay cuts as it may affect their morale and productivity in the workplace (Bar-Or, 2009:15; Bewley, 1998:459).

Although a major objective of business rescue is to ensure that jobs are preserved, in many cases, retrenchments are unavoidable and incorporated into the business rescue plan to cut costs (Loubser, 2013:450). When a reorganisation is announced, it may create uncertainty amongst employees, as they do not know if they will emerge as victims or survivors of the retrenchment process. Thus, employees tend to focus more on their personal futures and less on the needs of the company, resulting in a decrease in employee morale and productivity (Nghondzweni, 2017:16; Vollmann & Brazas, 1993:21).

This loss of employee morale and productivity may have damaging effects on a company's attempts to improve and could severely impede the success of a company's rescue attempt (Smith *et al.*, 2008:75). During times of change in distressed companies, stress, paranoia, and lack of trust between employees and management are at an all-time high. Thus, communication with employees is imperative to combat the decrease in employee morale because employees need to feel that their fears and concerns are being heard (Bar-Or, 2009:15).

#### **3.2.2.4 Key employee and management turnover**

As mentioned above, the threat of job losses through retrenchments may reduce employee morale, and voluntary employee turnover may increase. Consequently, the retention of key employees may become a major challenge for the company. Employees most likely to leave tend to be the most skilled, with valuable company-specific knowledge and expertise (Liou & Smith, 2007:87; Winer & Crook, 2016:3). There may be a high turnover of key employees, both blue and white-collar, if other suitable jobs exist in the market. Furthermore, competitors may take advantage of the distressed company's position and headhunt key employees (Tajti, 2017:11).

According to Altman and Hotchkiss (2006:219) and Gilson (1990:375), both senior management and board of director positions are likely to experience high turnover when a company is in financial distress and files for reorganisation proceedings. Management turnover may increase for several reasons. When a company is in distress or files for reorganisation, stakeholders tend to view management as tainted and incompetent, thus, management will receive most of the blame for the poor performance (Sutton & Callahan, 1987:412). It is argued that the image of a company and its management are intertwined. Thus, if stakeholders do not perceive management as credible, their faith in the company erodes (Sutton & Callahan, 1987:406). For this reason, changes to the management team are seen as a method of restoring stakeholder confidence. Management may be forced to resign due to the company's poor performance, even if the poor performance is not the result of the decisions made by incumbent management (Raden, 2015:20; Smith & Graves, 2005:306). Discredited managers, who feel embarrassed, may resign because of the personal trauma and time costs associated with dealing with a financially distressed

company (Gilson, 1990:373; Sutton & Callahan, 1987:406). Furthermore, management may be replaced if the incumbent management are unable or unwilling to make the changes that are necessary for recovery (Smith & Graves, 2005:307).

The loss of good employees and management can be considered an indirect cost of financial distress (Gilson, 1990:372). In contrast, financial distress can also provide the company with benefits when poor management is removed (Andrade & Kaplan, 1998:1471). However, distressed companies often face challenges in replacing key employees and management, thus, the costs associated with replacing these employees and management may be high. New employees will lack the company-specific knowledge of previous employees and thus, training costs may be high (Liou & Smith, 2007:90; Tajti, 2017:11). The company may be unable to attract people to serve as management because of the legal and time costs associated with board service in distressed companies (Gilson, 1990:372).

### **3.2.2.5    *The inability to raise finance***

According to Cook and Pond (2006:27), a significant indirect cost that distressed companies face is under-investment. Under-investment is defined as the inability to raise finance. Companies entering financial distress are cash deficient, thus, obtaining finance to meet day-to-day operating expenses and covering direct insolvency costs is one of the most important success factors (Calitz & Freebody, 2016:269; Cook & Pond, 2006:27). Companies may face bigger challenges in raising finance when it is subject to reorganisation proceedings, as lenders are concerned about the success of proceedings (Calitz & Freebody, 2016:270). The amount of free assets (i.e., unencumbered assets) increases the ability of a company to acquire additional funds needed for a successful recovery. However, one of the biggest reasons companies in reorganisation fail to secure finance is the lack of security and available unencumbered assets (Calitz & Freebody, 2016:266; Pretorius & Du Preez, 2013:176; Smith & Graves, 2005:307). Another factor affecting the company's ability to raise finance is their relationship with its existing creditors and the willingness of the creditors to participate in the reorganisation process (Winer & Crook, 2016:2). In a situation where a company is able to raise finance, creditors may demand higher interest rates as compensation for the increased risk (Bhabra & Yao, 2011:46).

In South Africa, Pretorius and Du Preez (2013:181) indicate that the extent of post-commencement finance ('PCF') is small to non-existent. Although the Act provides mechanisms through which financing becomes more attractive to the financier, the uncertainty around the ranking of creditors during business rescue contributes to the inability of companies to raise finance. This has created an additional obstacle to the BRPs already difficult task of raising PCF (Calitz & Freebody, 2016:273; Jones & Wellcome, 2016:25; Stoop & Hutchison, 2017:17). The lack of understanding of the business rescue legislation further contributes to the inability to raise PCF (Pretorius & Du Preez, 2013:181). The inability to raise finance is a major concern, as one of the most crucial factors in bringing about a successful rescue is the ability to successfully raise PCF (Calitz & Freebody, 2016:266; Pretorius & Du Preez, 2013:181).

### **3.2.2.6 *Inefficient asset sales***

Financially distressed companies are cash deficient and may be constrained in their ability to raise external finance to meet their obligations. One strategy to deal with this involves restructuring the assets of the company to generate cash to meet the company's obligations (Hotchkiss *et al.*, 2008:11). According to Brown, James and Mooradian (1994) and Hotchkiss (1995), companies in financial distress exhibit a high frequency of asset sales, whether the company opted for a formal reorganisation procedure or an out of court restructuring. During business rescue, the BRP may seek cash to pay for the company's day-to-day operating expenses or the company's debt, by selling off the unencumbered assets that are not critical for the company's operations (Turnaround Management Association, 2015b:5). However, companies are often seen to sell assets at depressed prices, in their "fire sale" attempts, to free up cash (Andrade & Kaplan, 1998:1471; Hotchkiss *et al.*, 2008:13).

A "fire sale" is defined as a forced sale of an asset at a depressed price. Assets sold in fire sales can trade at prices far below market value, causing severe losses to sellers (Shleifer & Vishny, 2011:30). An asset can be sold at a discounted price for several reasons. An asset may be sold quickly to pay for urgent expenses or in the instance where the company may not be able to raise finance over an asset due to financial distress (Shleifer & Vishny, 2011:31). In addition, assets may be sold at depressed prices when they are too industry-

specific (i.e., specialised). When an asset is industry specific, competitors of the distressed company may be facing financial constraints of their own and will be unable to pay market values for assets. In the case of an industry downturn, distressed companies may be forced to sell to well-financed users, who place a lower value on the asset (Hotchkiss *et al.*, 2008:13; Pulvino, 1998:940). In contrast, the proceeds of generic assets can be used productively in many industries, therefore, proceeds should not be depressed (Pulvino, 1998:942).

It can be argued that the sources of indirect costs, described in the literature review, may have a significant influence on business rescue proceedings and may present companies and BRPs with significant challenges. This fact highlights that there is a need to explore the indirect costs of business rescue proceedings. The next section describes the research methodology employed in this study.

### **3.3 METHODOLOGY**

#### **3.3.1 Research design**

The research approach for this study was exploratory in nature. The purpose of exploratory research is to obtain a general idea about the nature of the problem of the topic to be investigated and to identify potential problems for future research (Daniel, 2012). An exploratory approach was appropriate as the researcher wished to assess phenomena in a new light and was unsure of the precise nature of the problem (Saunders *et al.*, 2009:139). Given the exploratory nature of the study, a basic or generic qualitative research design was employed to explore the indirect costs of business rescue proceedings in South Africa (Leedy & Ormrod, 2013:96).

The purpose of qualitative research is to explore the opinions, perceptions, beliefs or experiences of multiple people regarding a specific topic under investigation (Plano Clarke & Creswell, 2015:289). Following a qualitative research design allowed the researcher to thoroughly explore BRPs' experiences of former business rescue cases. The qualitative research allowed the researcher to explore the opinions, perceptions, or beliefs of multiple BRPs with regard to a specific topic under investigation, namely, the indirect costs of business rescue (Plano Clarke & Creswell, 2015).

### 3.3.2 Sampling

In order for the study to explore and address the research problem, data regarding the indirect costs of business rescue were collected from BRPs. Thus, the units of analysis for this study were licenced BRPs. The sample consisted of 13 BRPs from Gauteng in South Africa. Guest *et al.* (2006:61) state that six to 12 interviews are sufficient for qualitative research, therefore, the final sample size was deemed as appropriate. The profiles and identifying characteristics of the individual participants are presented in Table 14. All participants in the study were male, however, this is an accurate reflection of the BRP population.

**Table 14: Participants' profile and identifying characteristics**

<b>Pseudonym</b>	<b>License</b>	<b>Background</b>	<b>Duration of the interview (minutes)</b>
BRP01	Senior	Finance	27
BRP02	Senior	Finance	21
BRP03	Senior	Business	38
BRP04	Junior	Legal	34
BRP05	Senior	Accounting	68
BRP06	Senior	Banking	49
BRP07	Senior	Liquidations	33
BRP08	Experienced	Accounting	46
BRP09	Senior	Banking	41
BRP10	Senior	Accounting	62
BRP11	Senior	Legal	32
BRP12	Junior	Accounting	38
BRP13	Junior	Legal	41
	<b>Average:</b>		<b>41</b>

A non-probability sampling method, specifically purpose sampling, was used to select participants for this study. Purposive sampling is a method where the researcher's judgement is used to select "information rich" participants and participants that will best inform the research question (Creswell, 2012:206; Daniel, 2012). For the purposes of this study, participants had to hold a junior, experienced, or senior BRP license; and participants had to be involved in, or administered, a minimum of one business rescue case. Snowball sampling was used to supplement the purposive sampling method. Participants were

selected based on the recommendation of others such as the recommendation of the researcher's supervisors, and participants who agreed to take part in this research study (Creswell, 2012:209).

### **3.3.3 Data collection**

Data for this study were collected through 13 one-on-one semi-structured interviews with BRPs. According to Rowley (2012:261), one-on-one interviews are most appropriate when the researcher requires the participant's thoughts, opinions and experiences to make conclusions about the topic at hand. One-on-one interviews are appropriate when there is insufficient knowledge of the topic to use questionnaires and when a deeper understanding is needed, as was the case with this study. Given the lack of current knowledge about the indirect costs of business rescue, semi-structured interviews were appropriate as they allowed for new issues to emerge for exploration (Saunders *et al.*, 2009:117).

The discussion guide was developed from an extensive literature review. The researcher's supervisors critically evaluated a first draft of the discussion guide. No major changes were made to the discussion guide as the feedback was positive. The 13 interviews lasted from 21 minutes to 68 minutes, with an average duration of 41 minutes (see Table 14) and were conducted at the participant's offices or at a boardroom at the University of Pretoria. All 13 interviewees granted permission to audio record the interviews. All 13 interviews were transcribed by the researcher, within 72 hours after each interview. In order to reflect the actual recording accurately, the researcher listened to each recording while reading the transcripts and, where necessary, made minor changes to the transcripts. A copy of the discussion guide used in the semi-structured interviews is included in Appendix A.

### **3.3.4 Data analysis**

A thematic analysis was conducted to analyse the interview data collected. Thematic analysis is a method for systematically identifying, organising, and offering insights into patterns of meaning across a data set and allows a researcher to make sense of collective or shared meanings and experiences (Braun & Clarke, 2012:57). Following the guidelines of Braun and Clarke (2012), the researcher first familiarised herself with the data by



analysing each transcript while listening to the audio recording. The researcher made notes on the data during this phase. Inductive codes were generated from the data and used to code applicable text segments. The first round of coding yielded 307 descriptive codes. The codes were then rethought, in terms of similarity and difference, and all redundant codes were combined through an iterative analysis. This process resulted in 77 codes. The revised codes were grouped into six descriptive and overarching themes. The identified themes were then analysed against the original transcripts to ensure that they covered all major patterns in the data. Table 24 to Table 29 (in Appendix G) list the codes, sub-themes and main themes (indirect cost sources) identified in the study. Each code is supported with verbatim quotations from the original transcripts.

### **3.3.5 Trustworthiness**

Four trustworthiness techniques, namely credibility, transferability, dependability and confirmability were employed to ensure the overall trustworthiness of the study's findings (Lincol & Guba, 1985; Polit & Beck, 2012:585). In order to ensure credibility, site triangulation was employed. Site triangulation entails making use of participants from several organisations so as to reduce the effects on the study of particular local factors that are specific to one organisation (Shenton, 2004:66). To ensure transferability, the researcher provided a "thick description" of the participants and the study's context (Shenton, 2004:70). A comprehensive description of the processes the researcher employed in the study are reported in detail, to ensure dependability (Shenton, 2004:70). Finally, the researcher stored all notes, transcripts and audio recordings in order to ensure confirmability (Milne & Oberle, 2005:416).

### **3.3.6 Ethical considerations**

The Research Ethics Committee of the Faculty of Economic and Management Sciences at the University of Pretoria approved the study in November 2017. Participant's informed consent to take part in the study was obtained before the start of the interview, as per the guidelines set out by the University of Pretoria. The consent form ensured that participants were provided with information regarding the purpose of the study, who the researcher is and how the data will be used. Participants were given pseudonyms to remove any

information that could be linked to the participants (i.e., participant and company names). This ensured that participants were granted the privilege of confidentiality and anonymity to prevent any harm against the participants or their firm.

### 3.4 FINDINGS AND DISCUSSION

In order to answer this study’s main research question, this study investigated six main sources of indirect costs (theme’s) related to the study’s six sub-research questions (see Figure 4). These themes and their related sub-themes are discussed in this section, accompanied by descriptive quotations from participants and linkages to relevant literature.

**Figure 4: Summary of research questions and related themes**

Research questions					
What indirect costs do companies experience while undergoing business rescue proceedings in South Africa?					
Do companies experience a loss of customer goodwill during business rescue?	Do companies experience a loss of supplier goodwill during business rescue?	Do companies experience a decrease in employee morale and productivity during business rescue?	Do companies experience a high turnover of key employees and management during business rescue?	Do companies face challenges in raising finance during business rescue?	Do companies sell assets at depressed prices during business rescue?
Themes: Sources of indirect costs					
Loss of customer goodwill	Loss of supplier goodwill	Decrease in employee morale and productivity	Key employee and management turnover	Inability to raise finance	Inefficient asset sales
Sub-themes					
- Challenges faced with customers - Factors influencing customer goodwill	- Challenges faced with suppliers - Factors influencing supplier goodwill	- Challenges faced with employees - Factors influencing employee morale	- Challenges faced with employee turnover - Factors influencing employee turnover	- Challenges in raising PCF - Factors influencing the ability to raise PCF	- Asset sales as a method to raise finance - Factors influencing proceeds

Source: Author’s own compilation.

#### 3.4.1 Loss of customer goodwill

##### 3.4.1.1 *Challenges faced with customers*

Participants offer mixed opinions as to whether a company experiences a loss of customer goodwill during business rescue. In so far as customers are kept informed and supply is not interrupted, customers may exhibit large amounts of loyalty during business rescue. In

contrast, several participants indicated that companies may experience difficulties with customers for various reasons. Customers may worry about a company's ability to supply as they are concerned about the longevity of the company. This is because business rescue is viewed as akin to liquidation. Customers may worry about the product quality and as a result, may mitigate their risk by finding alternative sources of supply.

Companies may experience other difficulties from customers, for example, customers often stop paying their debt as they do not believe the company will be around for long. This is consistent with Tajti (2017:10) who found that filing for proceedings makes collecting trade receivables all the more difficult. Based on the above discussion, it may be concluded that a loss of customer goodwill may result in lost opportunities in the form of lost sales. This may result in cash flow problems, which may further exasperate financial distress.

#### **3.4.1.2 Factors influencing customer goodwill**

Consistent with the findings of Farooq and Jibrán (2018:120), the findings of this study highlight that companies may experience a loss of customer goodwill due to competitor activity. Competitors may take advantage of the company's weaknesses by using aggressive marketing strategies to capture the distressed company's market share. The following quotation illustrates this:

“Because the business rescue process is so transparent, your competitors can get a hold of the business rescue plan and know exactly what the state of your business is and kind of take advantage of your weaknesses by going for your customers. So, it could affect your sales, you know you could lose some key customers.” (BRP07)

Customer goodwill is largely dependent on the types of product or services offered by the company. Participants highlighted three types of products or services where a company may typically experience a loss of customer goodwill during business rescue. Firstly, companies that produce products that require after sales services and come with guarantees. Secondly, companies that supply components that are inputs to their customer's products. These inputs may be critical to the customer's products, therefore, losing supply of these components will affect the customer's sales. Lastly, companies whose products or services require deposits or pre-payments experience the biggest loss of customer goodwill.

Participants stated that during proceedings, the company would not be awarded new contracts or tenders. In all three instances, customers are concerned about the longevity of the company and therefore will not take the risk and may, therefore, look for alternative suppliers.

Alternatively, participants indicated that companies that produce consumer goods and commodities typically do not experience a loss of customer goodwill. In this instance, if the distressed company is unable to supply goods, they are easily available and can be replaced quickly. In addition, companies in the retail industry typically do not experience a loss of customer goodwill, provided that they still have products on their shelves. In fact, one participant highlighted an instance where there was an increase in sales. Based on the above discussion, it appears that a customer's reaction to business rescue may be dependent on whether the company is a business-to-business or business-to-customer supplier. The following quotation illustrates this argument:

“Retailer B went into rescue and our sales performance went up in the stores and I don't know quite how that worked but if you track it you can see that more customers were going into the store. Now I don't know whether that's because its name was in the press more...but there was no sort of customer-focused indirect cost.” (BRP10)

Customer goodwill depends on how the BRP manages relationships with customers. Customers have many questions during proceedings, therefore, it is important for BRPs to respond to a customer's questions and concerns. Participants emphasised how important it is to go and see major customer's right at the beginning of proceedings to ensure that supply will not be interrupted. Participants stressed that it is important to be open and honest from the beginning of proceedings. Ongoing communication with customers and keeping customers updated throughout the process is imperative to ensure customers do not lose confidence in the process.

Moreover, participants stated goodwill also comes down to the BRPs skill and how proactive they are in implementing systems and procedures that will bring customers comfort. Examples include opening a trust account with a firm of attorney's where customers' deposits will be managed, as well as altering payment terms by requesting that customers

pay the company's supplier directly for raw materials, if the company is experiencing severe cash flow problems (Bode *et al.*, 2014:32-33).

Lastly, customer knowledge of proceedings may influence whether companies experience a loss in goodwill. Companies are not legally required to notify customers that they are in business rescue, therefore, in some instances, customers do not even know their suppliers are in business rescue and as a result, these companies may not experience a loss in goodwill.

### **3.4.2 Loss of supplier goodwill**

#### **3.4.2.1 *Challenges faced with suppliers***

There was a consensus amongst participants that companies face massive challenges with suppliers after filing for business rescue. Consistent with the findings of Pretorius (2015:65), during proceedings suppliers often refuse to extend trade credit and tend to put companies on aggressive payment schedules, such as requesting COD or cash-in-advance ('CIA'). Other difficulties mentioned were that suppliers may attempt to increase the cost of goods and services supplied to recover the debt owed before business rescue. In addition, suppliers may refuse to continue doing business with the company until the company settles their arrears. One participant indicated that, in some instances, suppliers sometimes insist on CIA and use that payment to settle old debt and do not deliver the goods. The following quotation illustrates this:

“...then what also happens is they say “we will supply you on cash” then you pay the cash and then they don't deliver. They just say they will put it off your old account. That does happen, very unprofessional but it does happen.” (BRP13)

It appears that companies face major challenges with banks when filing for business rescue. In fact, one participant believes banks are one of the biggest obstacles to a business rescue attempt. As soon as a company files for proceedings, banks are likely to withdraw facilities by cancelling overdraft facilities or freezing the company's bank accounts. One of the reasons banks withdraw facilities is because the overdraft facility is secured by a cession of debtors. In this instance, banks are of the opinion that the debtors of the company remain

the property of the bank. Banks may also increase interest rates charged on bank accounts. The difficulties BRPs face with banks is illustrated by the following quotation:

“...the bank froze the account immediately. We convinced them to open a new account, but then it took us two weeks to get statements on the old accounts so that we can say “these deposits are post-rescue deposits and you have to give them to us”. Sometimes the bank refuses to give them to us then you have to go to court for an urgent application to compel them to act.” (BRP10)

Participants indicated that BRPs need to spend a substantial amount of time dealing with suppliers in order to minimise the issues mentioned above. Participants indicated that many suppliers still do not understand business rescue. BRPs, therefore, need to spend time negotiating with suppliers and answering supplier’s questions and concerns. As a result, these difficulties distract BRPs from the task at hand, and that is rescuing the company.

Participants are of the opinion that a lack of support from suppliers, may be detrimental to a company’s business rescue attempt. The issues mentioned above may place additional pressure on a company’s immediate cash flow. Consequently, a company may not be able to purchase stock and therefore, productivity may decline. The findings of this study confirm those of Bisogno and De Luca (2012:23), who indicate that a loss of supplier goodwill may result in lost opportunities in the form of lost sales. The following quotation highlights this:

“You can’t get stock, you can’t trade and then you doomed for failure. So, it’s really as simple as that. If your creditors don’t support you in business rescue, I question if your business rescue can actually be successful.” (BRP04)

#### **3.4.2.2 Factors influencing supplier goodwill**

The findings reveal that the company’s ability to pay cash has a major influence on supplier goodwill. If the company is able to pay COD or CIA, they may experience minimal difficulties with suppliers. Some suppliers exhibit a large amount of loyalty; however, they cannot take further risk and therefore these suppliers will continue to support the company but on a COD or CIA basis. Participants stated that once they have gained the trust of suppliers by purchasing on a COD or CIA basis, in some instances, they are even able to renegotiate

payment terms. Sometimes suppliers may even be willing to take a compromise on previous debt as the company started paying the supplier cash.

The extent, to which suppliers are compromised in the business rescue plan, may influence how suppliers react and in turn, how much difficulty a company will experience with suppliers. This is evident by the following quotation:

“If the plan is to pay them back all their money, then they are more lenient towards helping you out and to keep on supplying you, even at the existing terms...But if the plan has any sort of compromise, you can forget about them supplying you. They will go over to a cash basis. So, if you don't pay cash, they are not going to help you.” (BRP13)

Consistent with previous studies management behaviour in the run-up to business rescue may often affect supplier goodwill more than the act of filing for proceedings (Cook & Pond, 2006:28; Sutton & Callahan, 1987:412). Often, by the time a company files for business rescue, the trust relationship between the company and supplier has been broken down for several reasons. Firstly, the company may have lied about payment terms and may have not kept their promises. Secondly, management may have hidden the financial distress and filed for business rescue. In this instance, suppliers feel hurt because they were not taken into confidence and told that the company was filing for business rescue.

Due to the above, participants indicated that supplier goodwill depends on the BRPs ability to restore and maintain relationships with suppliers. It is incumbent upon the BRP to have the necessary skills to placate suppliers and to convince suppliers to continue doing business with the company. It is important to communicate with suppliers as early as possible and tell them what the circumstances behind the financial distress are and what the plan is going forward.

The BRPs reputation in the market influences supplier goodwill and has an impact on the degree of the difficulties experienced with suppliers. A BRP with a good reputation may pacify suppliers and help remedy the loss of goodwill because suppliers may trust the BRP more. However, suppliers, especially banks, will often not support the business rescue if the BRP has a bad reputation and therefore, these suppliers may become obstructive. The importance that is placed on a BRPs reputation is illustrated by the following quotation:

“Practitioner reputation with your suppliers, your creditors, your banks and all of those...if it’s the wrong practitioner, they will never vote for the plan. They will just be obstructive from day one and they will do their best to get that practitioner removed. If it’s the right practitioner, they willing to work with you. That gets back to how you deal with, for example: what type of fees do you try to sneak into your agreements, how you deal with your creditors, how do you maintain those relationships, are you transparent, are you open, are you honest. So, all of that comes back to the practitioner.” (BRP05)

### **3.4.3 Decrease in employee morale and productivity**

#### **3.4.3.1 *Challenges faced with employees***

The findings indicated that the act of filing for business rescue, in itself, results in some adverse emotions among employees. Because of business rescue’s low success rate, employees deem rescue to be the death of the company. As a result, when a company files for business rescue, an employee’s immediate reaction is: *Will I have a job? Will I get paid? Will the company succeed?* Therefore, filing for business rescue has a massive impact on an employee’s sense of job security and stability. These findings confirm those of Vollmann and Brazas (1993:21), who indicate that the uncertainty may result in feelings of fear, anger and resentment towards management and as a result, employees may become insular and may start looking for alternative employment.

In contrast, participants expressed that in some cases, employee morale was low before business rescue commenced. This is because staff have witnessed the gradual decline of the company or have been paid late. As a result, employee morale may increase during proceedings, as employees see change happening; or a change in management sparks renewed energy.

A decrease in employee morale may have several negative effects. Firstly, a general decrease in employee morale may result in a general decline in productivity as employees who do not see a future for themselves at the company often do the bare minimum. Employee productivity may decrease as employee absenteeism may increase whilst employees are looking for alternative employment. Secondly, safety may decrease, as employees are preoccupied and worried about whether they will have a job. The decrease in safety levels may result in workplace injuries. Lastly, theft may increase due to the



uncertainty of job losses. Due to the above, BRPs need to monitor employees and spend time engaging with employees. Participants indicate that this is a very time-consuming task. In summary, the decrease in employee morale and the consequent reduction in productivity, may result in lost opportunities in the form of lost sales. A decrease in employee morale and productivity is illustrated by the following quote:

“...employees will try and maximise their sick leave if a company goes into business rescue. You have got casual labour and they will just not [show] up for work, they will go for interviews at other companies and employees will probably do the minimum that’s where it’s at. If you don’t see a future for yourself why should I put myself out there. So that’s what happens.” (BRP04)

### **3.4.3.2 Factors influencing employee morale**

The findings reveal that the level of education and the understanding of business rescue by the employees may influence whether an employee experiences a decrease in morale. Generally, blue-collar workers are unlikely to understand business rescue and therefore participants expressed that the morale of blue-collar workers may be largely influenced by a company’s ability to continue paying wages. This finding confirms those of Bewley (1998:459), who states that employee morale is adversely affected by pay cuts. In contrast, white-collar workers may immediately become concerned about their long-term future at the company and start searching for alternative employment. Consequently, companies may experience a high turnover of key employees. Employee turnover is expanded on in the next section.

The degree to which employees experience a decrease in morale may be impacted by the BRPs communication skills. In line with Bar-Or (2009:15), the findings indicated that during periods of uncertainty, employees need to feel that their fears and concerns are being heard. Participants stressed how important it is to communicate with employees and explain the cause of the distress and what the future plan is going forward. Therefore, the first employee meeting is critical for answering all questions and concerns. However, participants emphasised that the communication needs to be honest and transparent. The influence that a BRPs communication skills have on employee morale is illustrated below:

“So, it [employee morale] depends on how well you communicate with large numbers of staff. So, you have to have active communication about what the process is, what’s happening now, what’s happening next, where are we with salaries and wages, when are they going to get paid. It’s about your communication skills.” (BRP08)

Lastly, it appears that a BRPs relationship with unions has an impact on the extent of difficulties faced with employees. Some participants are of the opinion that if employees are unionised, BRPs will experience more difficulties as unions generally do not understand business rescue. In contrast, other participants emphasised that it is important to build a relationship with unions because communicating and dealing with employees is much easier through unions as employees tend to trust unions.

### **3.4.4 Key employee and management turnover**

#### **3.4.4.1 *Challenges faced with employee turnover***

Consistent with previous studies (Altman & Hotchkiss, 2006:219; Gilson, 1990:375; Tajti, 2017:11), this study found that there is an increase in both voluntary and involuntary turnover during business rescue. In line with Liou and Smith (2007:87), this study found that voluntary employee turnover may increase, especially amongst key employees, as they are worried about their future as mentioned in the previous section. When good employees leave a company, institutional knowledge leaves with them. This knowledge is not easily replaceable and takes time for new employees to gain. As a result, the loss of good employees may make running the business rescue more challenging. The loss of institutional knowledge may limit the ability of the BRP to make quick decisions. The following quotation highlights the importance of retaining good employees:

“...it is that institutional knowledge and under circumstances where you are distressed you have to make quick calls and quick calls can only be made if you have good information, good information only comes from quality people.” (BRP11)

When key employees leave, those positions need to be filled and may come with significant costs. The company may not be able to find suitable replacements due to the skill shortages in South Africa and because the company cannot offer prospective employees’ job security. As a result, indirect costs may increase as the company may have to fill the position with

people of lesser competence. If a replacement is not available, the company may need to replace employees with contractors and thereby increase the direct costs of business rescue as these consultants may charge substantial hourly rates. If a suitable person is hired, direct costs increase as training costs may be significant as new employees lack the institutional knowledge of previous employees (Liou & Smith, 2007:90; Tajti, 2017:11). In some instances, this valuable institutional knowledge is lost as it may be undocumented and can only be gained through experience.

Contrary to the above, some participants stated that the increase in voluntary turnover is not always an issue, in fact, it can offer the company some advantages. In some instances, there are employees that the company would like to remove but these employees voluntarily resign. Participants indicated that employees often take voluntary retrenchments; therefore, the company does not have to worry about retrenching employees. Lastly, some participants indicated that losing key employees is not a threat as they will plan and fill the void.

This study found that there may be an increase in involuntary turnover of employees, specifically management during business rescue. Participants stressed that it is often necessary to remove management in order to have a successful rescue. This is illustrated by the following quotation:

“Here’s the truth, I have never gone into a rescue with the intention of changing management, I have never come out of a rescue not having changed management. It’s just, you need fresh people, it’s required.” (BRP06)

Consistent with previous studies conducted by Andrade and Kaplan (1998) and Sutton and Callahan (1987), this study found that the removal of poor management may offer a distressed company some benefits. According to Sutton and Callahan (1987), the removal of poor management may improve relationships with stakeholders. In some instances, the removal of poor management might actually increase employee morale, as poor management was the cause of decreased morale. Employees do not want to follow management if they believe they are the problem. In this instance, management is held accountable for their actions and employees can see change and see that the company is going in the right direction. In addition, participants indicated that the removal of bad

management may also improve relationships with suppliers as they can see change happening.

In conclusion, companies in business rescue may experience an increase in employee turnover. Companies that experience increased employee turnover may not be able to take advantage of opportunities due to the lack of human resources, therefore, companies may experience indirect costs in the form of lost opportunities.

#### **3.4.4.2 *Factors influencing employee turnover***

This study found that there are several factors that may influence employee turnover. Consistent with the findings of Tajti (2017:11), competitors often seek to take advantage of companies during business rescue and therefore, key employees are much more likely to be headhunted by a competitor. Key employees often have more options outside the company than the less-than-stellar employees do and therefore, they are the first to leave.

Several participants indicated that it is important to take measures to ensure the company does not lose good employees. One way to address the risk of losing key employees is to conduct a pre-assessment to identify employees who are critical to the business rescue and incentivise them to stay and bring them on board as part of the business rescue effort. One participant emphasised that it is important to not drag out business rescue as the longer the proceedings take, the more employees lose confidence and the higher the turnover. The importance of taking measures to retain key employees is highlighted by the following quotations:

“What we sometimes do in our matters, as part of our pre-assessment or early assessment, is we identify people who are critical for a successful rescue and you try and incentivise them to stay.” (BRP11)

“...it depends on how you engage with those staff. So you want to find out who the key staff members are and who the good ones are that you need to keep and you need to work with them...if you, as practitioner, are continuously engaging with those staff members, then they are more likely to stay and they are less likely to get demotivated. The quickest thing that will make them leave is if they are sitting there and they are thinking “I’m not really doing anything, and nobody really cares what I’m doing, my job is

probably not even that important and I'll probably be out of a job in three months' time, so let's start looking for a new job". (BRP12)

The findings revealed three occasions where there may be an increase in management turnover. Firstly, consistent with the findings of Raden (2015:20), if the management team is the reason for the financial distress, or is seen as the reason for the distress, that same management team cannot be the team to take the company out of trouble. Therefore, it is important to have a change in management. This is emphasised by the following:

"You've got to ask yourself, if this board or management team managed to drive this bus up a dark alley they couldn't get out of, are they the right people to reverse it out? I'm not sure they are." (BRP06)

Secondly, participants mentioned cases where management was removed due to theft or fraud. Lastly, a critical factor for a successful rescue is unconditional support from management. Management may be an obstacle to the business rescue because they are resistant to change or because management is showing self-interested behaviour, which results in conflict. In these instances, it is important to remove management in order to proceed with proceedings.

### **3.4.5 Inability to raise finance**

#### **3.4.5.1 *Challenges in raising post-commencement finance***

According to participants, without PCF a business rescue attempt cannot be successful, therefore, the ability to raise PCF is crucial. This is supported by Pretorius and Du Preez (2013:189), who found that a lack of PCF is one of the main reasons business rescues have failed. One participant stressed the importance of PCF by indicating that they would not accept appointments without knowing whether they will be able to secure PCF.

Although PCF is one of the most important factors for a successful rescue, raising PCF during business rescue, is one of the biggest challenges BRPs face. If a BRP is able to secure PCF, it comes at a higher cost in terms of the interest rate and fees charged, such as the raising fee charged. This is supported by Bhabra and Yao (2011:46), who state that financiers may charge higher interest rates as compensation for the increased risk.

Companies in business rescue often lack the finance to run the day-to-day operations of the company as well as the finance to repay creditors. As a result, companies may forgo profitable opportunities as they may lack the finance to expand into new markets or to invest in research and development. As a result, companies in business rescue may experience indirect costs in the form of lost opportunities.

#### **3.4.5.2 Factors influencing the ability to raise post-commencement finance**

Consistent with the findings of Pretorius and Du Preez (2013:181), this study found that one of the main reasons that BRPs struggle to raise PCF is that the distressed lending market is underdeveloped and virtually non-existent in South Africa. As a result, companies must turn to other parties - such as major lenders, shareholders or private equity lenders - for funding. However, companies still face major challenges in raising PCF from these parties. The ability of a BRP to raise PCF depends on the security available. However, by the time a company has filed for proceedings, most companies do not have free assets left to use for securing PCF. The lack of free assets is discussed in the next section. Participants emphasised that having security available is only the first step in the process of obtaining PCF. In addition to looking at the company's security, lenders typically look at the BRPs reputation and the management of the company.

In line with Jones and Wellcome (2016:25) and Stoop and Hutchison (2017:17), the findings indicate that the uncertainty around the ranking of creditors, during business rescue proceedings, contributes to the inability of companies to raise finance. The following quotation illustrates this:

“There's just not enough certainty around the ranking and we all know what it's intended to mean but it doesn't say that, so your sources of PCF funding are limited...” (BRP11)

Often, companies cannot raise finance from various parties as they have lost credibility with these parties because they have not honoured previous commitments or management is blamed for the distress. This finding is supported by Winer and Crook (2016:2), who state that the ability to raise PCF largely depends on the company's relationship with their existing creditors. It appears that a BRPs reputation plays an important role in a company's ability to

raise PCF. There are some BRPs that banks will not work with due to past experiences. The following quotation supports this:

“Oh yes, practitioner reputation is the most important thing. They won’t even look at the assets if the wrong practitioner is in place. They will not provide finance to the wrong practitioner or to someone they had a negative experience with before.” (BRP05)

### **3.4.6 Inefficient asset sales**

#### **3.4.6.1 *Asset sales as a method to raise finance***

According to Hotchkiss *et al.* (2008:11), one strategy to deal with financial distress involves the sale of assets, such as equipment or subsidiaries, to generate cash to meet the company’s obligations. Participants agreed that this is a strategy often used during business rescue to raise cash to repay creditors or to fund the company’s operations. However, asset sales need to be part of the business rescue plan and approved by creditors to avoid prejudicing creditors.

Participants indicated that BRPs typically look toward selling underutilised assets, superfluous assets or obsolete assets. Participants warned against selling income generating assets or assets that would impact the core operations of the company. In some instances, BRPs may sell non-core subsidiaries that have the potential to be a lucrative business in the future. Although this may result in lost opportunities in the form of lost sales, it is sometimes imperative to save the core business, especially in cases where the company cannot raise PCF. The importance of asset sales is emphasised by the following quotation:

“...you must remember what I’m trying to do is avoid liquidation. So, if it’s that I end up with half the business that I had before, but I put everybody in a better position than they would have been under liquidation, then I’m surely in a better position. So, if I keep two divisions and they go into liquidation or if I had one and I’m solvent and my creditors get paid, surely there’s no debate.” (BRP06)

In contrast, participants indicated that often assets are not sold during proceedings because, by the time the company files for business rescue, there are no free assets left. This finding is consistent with previous studies indicating that companies in reorganisation do not have sufficient free assets (Calitz & Freebody, 2016:266; Pretorius & Du Preez, 2013:176; Smith

& Graves, 2005:307). In these instances, management may have sold off assets and raised finance over some assets in an attempt to resolve the financial distress. Participants stated that this signals that a company may have filed for proceedings too late and may eventually land up in liquidation. The following quotation illustrates this:

“Usually when you get there all unencumbered assets are gone, they are already sold. So that puts the emphasis on filing for business rescue in good time. If you going to start selling off assets, it’s too late to file for business rescue basically.” (BRP09)

### **3.4.6.2 Factors influencing proceeds**

According to participants, assets sold during business rescue are typically sold for a value between forced sale value and market value. Therefore, proceeds are normally fair under the circumstances. Asset sale proceeds depend on several factors. Firstly, the proceeds will depend on how quickly the BRP needs to sell the asset. If the asset needs to be sold urgently, then it will most likely be sold at a discount. Secondly, proceeds will depend on the type of asset sold. Inevitably, the more specialised the asset, lower the proceeds. This finding confirms those of Pulvino (1998), who found that companies who sell specialised assets typically receive discounted rates compared to a company selling a generic asset.

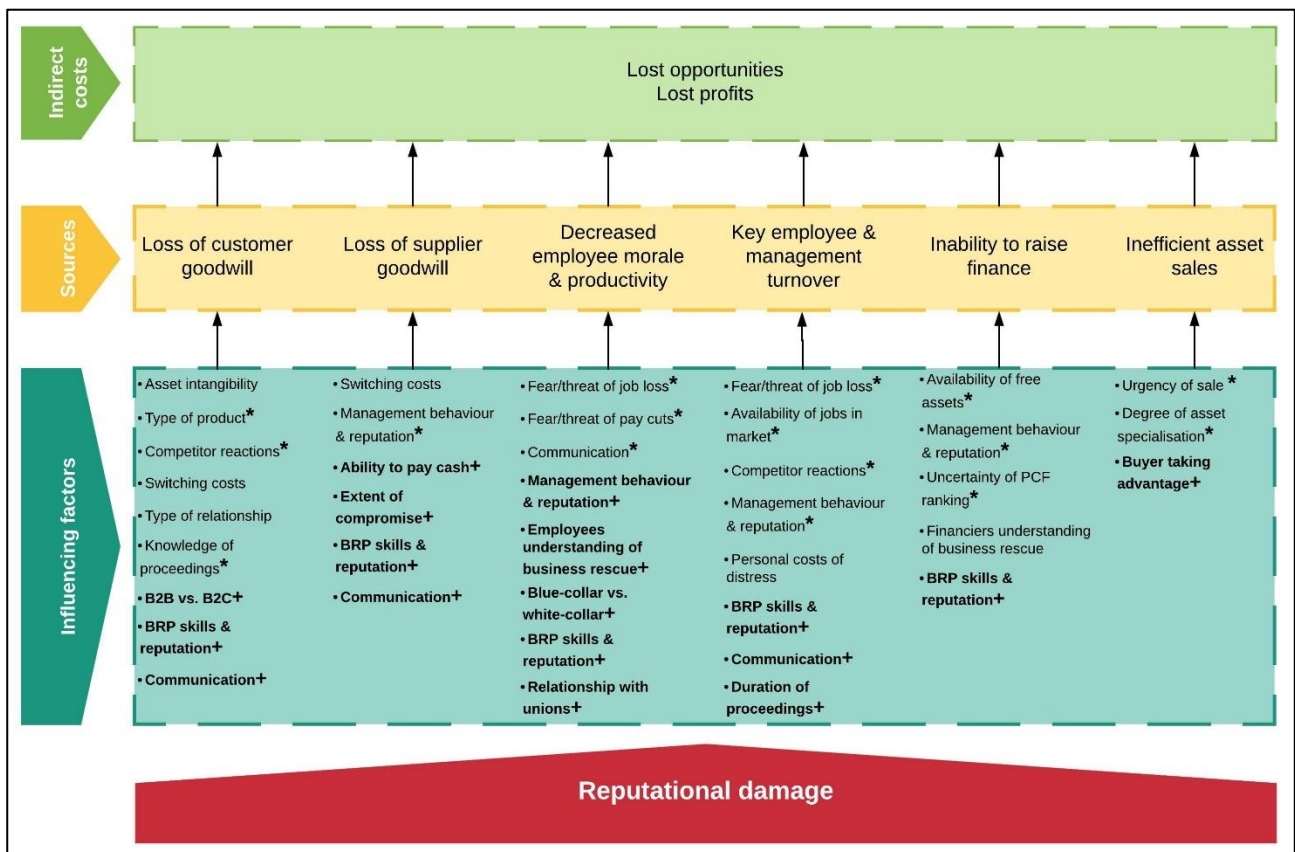
Lastly, if buyers know that the seller is in business rescue, they often try to take advantage of the company’s position and as a result, make a low offer. Although proceeds of asset sales are often discounted, participants indicated that sometimes these sales are important if they can save the core business.

## **3.5 CONCLUSION**

The purpose of this qualitative study was to explore the indirect costs of financial distress that companies face, as a consequence of participating in business rescue proceedings in South Africa. According to Altman (1984:1072), indirect costs are unobservable in nature and difficult to specify, therefore this study investigated six important sources of indirect costs that were identified in the literature. Figure 5 displays a visual depiction summarising the findings of this research.



**Figure 5: A visual depiction of indirect financial distress costs in South Africa**



Source: Author's own compilation

Notes:

\* = Influencing factor identified in literature is supported by findings.

+ = additional influencing factors identified by the study.

At the first level, the indirect costs that are most widely measured in literature are displayed. The second level shows the six sources of indirect costs investigated in this study. The findings of the study reveal that companies in business rescue experience the following: a loss of customer and supplier goodwill; a decrease in employee morale and productivity; increased turnover of key employees and management; the inability to raise finance; and inefficient asset sales. However, there are several factors that influence the severity of the sources of indirect costs. The third level displays the factors influencing the sources of indirect costs that were identified from the literature and the findings of this study. Figure 5 depicts the influencing factors that were supported by the findings of the study. In addition, the findings of the study identified additional influencing factors that were not highlighted in the literature.

Although companies in business rescue may be affected by indirect costs, it appears that indirect business rescue costs may actually offer companies several benefits. Firstly, a company may not have to retrench employees due to the increase in voluntary employee turnover. Secondly, the removal of poor management may increase employee morale and improve relationships with various stakeholder groups. Lastly, although the sale of assets may result in lost opportunities, it may save the core business. In addition, the sale of assets may result in the sale of poorly performing assets (Andrade & Kaplan, 1998:1471).

### **3.5.1 Managerial implications**

This research contributes to the management body of knowledge by providing stakeholders with a starting point into understanding the indirect costs of business rescue proceedings from a South African perspective. Understanding indirect costs may assist stakeholders involved in the process to find strategies that will maximise value preservation of the company and reduce the negative impact for all stakeholders involved.

### **3.5.2 Limitations and recommendations for future research**

This study presents three main limitations. Firstly, this study only considered the perspective of one stakeholder group, namely that of the BRP. As a result, the findings only reflect a single point of view, which may be incomplete and biased. Secondly, the responses from participants may be subjected to social desirability bias due to the fact that business rescue has been heavily criticised (Saunders *et al.*, 2009:327). Future research should involve other stakeholder groups, such as large creditors, directors of companies, and employees to attain more diverse perspectives. Lastly, although Guest *et al.* (2006:61) state that six to 12 interviews are sufficient for qualitative research, the researcher acknowledges that the number of participants interviewed limits the generalisability of the findings. Although the findings cannot be generalised, this study provides a starting point for future research into the indirect costs of business rescue proceedings. Future research should consider conducting a quantitative investigation to measure the indirect costs of business rescue.

CHAPTER 1: Introduction 2

CHAPTER 2: Paper 1 10

CHAPTER 3: Paper 2 57

CHAPTER 4: Summary and conclusion 93

CHAPTER 5: List of references 101

## **CHAPTER 4: SUMMARY AND CONCLUSION**

### **4.1 INTRODUCTION**

This study aimed to provide a better understanding of the direct and indirect costs associated with business rescue proceedings in South Africa. In order to achieve this, the researcher conducted two studies, resulting in two articles. Each article offers detailed findings and conclusions summarising the results in each study. In addition, each article offers its own managerial implications, limitations, and recommendations for future research. The purpose of this chapter is to provide a summary of the study's research objectives, research questions and conclusions.

### **4.2 PAPER 1: SUMMARY AND CONCLUSIONS**

In the first study, the researcher explored the direct costs by conducting an exploratory sequential mixed methods study. Phase one of the study was a generic qualitative exploration to identify the direct costs of business rescue and the components of the direct costs. During this phase, qualitative data were collected from 14 BRPs. From the initial exploration, the qualitative findings were used to develop an instrument that was administered to a sample of BRPs in order to measure the direct cost components of business rescue proceedings for 19 companies that were previously under business rescue in South Africa. In addition, the study examined the relationship between the direct costs of business rescue and considered variables, such as company size and duration of business rescue proceedings. The four research objectives that this study set out to investigate are discussed below.

The first research objective was *to identify the direct costs of business rescue proceedings in South Africa*. An investigation into the direct costs was necessary as it appears that there are mixed opinions on what a BRP is entitled to charge and what a BRP may be reimbursed for. Research objective one addressed this issue by investigating and identifying the direct costs of business rescue and the components of these costs. The study offers BRPs' opinions on the direct cost categories and components. The findings revealed that direct

costs consist of four categories and these categories consist of various components (see Figure 2). The four categories are as follows:

- The basic remuneration of the BRP (S143(1)).
- Contingency fees (success-based fees) (S143(2)).
- Professional fee disbursements (S143(1)).
- General disbursements (S143(1)).

The first sub-objective was *to measure the direct costs of business rescue proceedings for companies that were previously under business rescue in South Africa*. Business rescue costs are often criticised and blamed for the low success rates of proceedings. It is for this reason the researcher investigated research this objective. The findings revealed that total direct costs average 3.36% of the total asset value. The total BRP fees, which consisted of the basic remuneration of the BRP and contingency fees, appears to be the largest direct cost (60.83% of total direct cost). This is followed by professional fee disbursements, specifically legal fees (30.60% of total direct cost).

Sub-objectives two and three were *to investigate the relationship between the direct costs of business rescue and the size of the company* and *to investigate the relationship between the direct costs of business rescue and the duration of business rescue proceedings*. The study's findings indicated that there is a significant positive relationship between company size and direct costs of business rescue. Therefore, direct costs increase with the size of the company. The findings suggested that there is no relationship between duration and the direct costs of business rescue proceedings.

Due to the presence of outliers, the researcher conducted a separate analysis whereby outliers for both  $H_1$  and  $H_2$  and the two hypotheses were tested. Once outliers were removed, the findings for  $H_1$  suggested that there is no relationship between company size and the direct costs of business rescue proceedings. In addition, the results for  $H_2$  suggested that there is no statistically significant relationship between duration and direct costs. These contradictory findings are not surprising given the small sample size. The researcher is aware of the fact that the results of the study are by no means sufficient to generalise to the

larger population; however, the researcher hopes this study can provide a starting point for future research into the direct costs of business rescue proceedings.

### 4.3 PAPER 2: SUMMARY AND CONCLUSIONS

In the second study, the researcher conducted a qualitative exploration of the indirect costs of financial distress companies face, as a consequence of participating in business rescue proceedings in South Africa. It is argued that indirect costs may hinder the success of a business rescue attempt. For this reason, an investigation into the indirect costs was deemed as appropriate as indirect costs are argued to be substantially higher than direct costs.

This study aimed to answer the following question: *What indirect costs do companies experience while undergoing business rescue proceedings in South Africa?* Indirect costs are difficult to quantify and specify. For this reason, this study has expanded on this question by focusing on and investigating six important sources of such costs that were identified in the literature. The specific questions answered through this research study are summarised below (see Figure 5 for a summary of the findings).

The first question was: *Do companies experience a loss of customer goodwill during business rescue?* The findings revealed that a company may experience a loss of customer goodwill during proceedings which may result in decreased sales and cash flow problems. The extent to which a company experiences lost goodwill is influenced by several factors. In line with the literature, this study found that customer goodwill is influenced by the type of product or service offered by the company, competitor reactions to the company's filing and whether the customer is aware of the fact that the company is in business rescue. The study found additional influencing factors namely, whether the company is a B2B or B2C supplier, the BRPs skills and reputation, and the extent to which the BRP and the company communicate with customers.

The second question was as follows: *Do companies experience a loss of supplier goodwill during business rescue?* The findings revealed that companies experience major challenges with suppliers, especially banks, during business rescue. In line with literature, management

behaviour and reputation influence the extent of lost goodwill. The study identified several influencing factors namely, the company's ability to pay cash, the extent to which creditors are compromised in the business rescue plan, the BRPs skills and reputation, and the extent to which the BRP and the company communicate with suppliers.

The third question this study set out to answer is: *Do companies experience a decrease in employee morale and productivity during business rescue?* During proceedings, companies may experience a decrease in employee morale and productivity which may result in increased turnover. In contrast, the opposite may be true as employees see positive change taking place. Employee morale may be affected by the fear of job losses or pay cuts, and the level of communication between the company and employees. This finding is in line with the literature. Additional influencing factors identified in this study are as follows: management behaviour and reputation, an employee's understanding of business rescue, whether employees are blue-collar or white-collar employees, the BRPs skill and reputation, and the BRPs relationship with unions.

The fourth question was as follows: *Do companies experience a high turnover of key employees and management during business rescue?* The findings indicated that a company may face increased levels of voluntary and involuntary turnover of key employees and management. Although this may present a company with several challenges, it may also provide the company with some benefits. Increased voluntary turnover may allow a company to avoid expensive retrenchments and the removal of poor management may improve relationships with various stakeholders. In line with the literature, the following may influence employee turnover: the fear of job losses, the availability of jobs in the market, competitors' reactions, and management's behaviour and reputation. Additional influencing factors that emerged during the study are as follows: the BRPs skills and reputation, the extent of communication with employees, and the duration of business rescue proceedings.

The fifth question this study set out to answer was as follows: *Do companies face challenges in raising finance during business rescue?* The findings highlighted that companies face massive challenges in raising PCF during business rescue proceedings. In line with the literature, the ability to raise PCF is influenced by the availability of free assets, management behaviour and reputation and the uncertainty regarding the ranking of PCF in the Act. The

study found that an additional factor influencing the ability to raise PCF is the BRPs' skills and reputation.

The final research question was as follows: *Do companies sell assets at depressed prices during business rescue?* The findings revealed that assets sold during business rescue are typically sold for a value between forced sale value and market value. The proceeds of asset sales are influenced by the urgency at which assets are sold, and the degree to which assets are specialised. An additional factor that may influence proceeds is buyers taking advantage of the fact that the company is in business rescue by attempting to buy assets at depressed prices. Although a company may sell assets at depressed prices, the sale of poor performing assets may be advantageous as it could benefit the rescue attempt.

#### **4.4 REFLECTIONS ON THE CONTRIBUTION OF THE STUDY**

The study explored the direct and indirect costs associated with business rescue in South Africa. By doing so, it makes several contributions to existing business rescue and formal turnaround literature. As far as the researcher could determine, there are no studies exploring the costs associated with business rescue proceedings in South Africa. This observation demonstrates the originality of the study. By exploring the direct and indirect costs for South African companies, the study may provide first insights into a potential comparison of these costs with studies conducted in other jurisdictions. In addition, the findings of this study may initiate further exploration into the topic of business rescue costs.

An understanding of the direct costs offers several advantages. An investigation into the direct costs was necessary as it appears that there are mixed opinions on what a BRP is entitled to charge and what a BRP may be reimbursed for. This study provides a starting point to understanding the direct costs of business rescue. By identifying and describing these direct costs, the findings may offer affected parties some insight and clarity as to the nature of these costs. The sample size for the quantitative phase of the first study was by no means sufficient to generalise the findings to the larger population. However, the findings provide some insights into the magnitude of the direct costs and the researcher hopes to initiate further exploration into the topic. The findings on the direct costs may assist BRPs, the management of distressed companies, and affected parties, as understanding the size



and determinants of the direct costs are important before stakeholders can find strategies to reduce these costs.

The findings of the second study on indirect costs may assist BRPs, managers of distressed companies and affected parties. The findings may assist stakeholders to better understand the challenges distressed companies face and how these challenges may affect the performance of companies during proceedings. Furthermore, understanding indirect costs will assist stakeholders involved in the process to find strategies that will maximise value preservation of the company and reduce the negative impact for all stakeholders involved.

#### **4.5 LIMITATIONS OF THE STUDY**

The qualitative phase of paper 1 only considered the perspective of one stakeholder group. Consequently, the findings only reflect a single point of view, namely that of the BRP, which may be incomplete. Given how the costs of business rescue have been increasingly criticised, the responses from participants may be subjected to social desirability bias (Saunders *et al.*, 2009:327). Furthermore, although Guest *et al.* (2006:61) state that six to 12 interviews are sufficient for qualitative research, the researcher acknowledges that the number of participants interviewed in the qualitative phase of paper 1 may limit the generalisability of the findings. However, although the findings cannot be generalised, this study provides a starting point for future research into the direct costs of business rescue proceedings.

Several limitations may be present related to the data collection method used for the quantitative phase of paper 1. Firstly, the results of the study cannot be generalised to a larger population on statistical grounds. This is due to the small sample size and the fact that a non-probability sampling method was used to select business rescue cases. Secondly, the fact that the cost data were collected using questionnaires, may result in several limitations. Given the sensitivity of the cost data, the responses on the questionnaire may be subject to deliberate falsification, whereby participants deliberately provide a false answer to a survey question (Zikmund *et al.*, 2010:191). Although the researcher took measures to minimise the impact of this error, there is no way to validate the responses.

A potential shortcoming of the quantitative phase of paper 1 is that the total direct cost of business rescue may be underrepresented for several reasons. Firstly, participants were constrained by the researchers' structure of the direct costs in the questionnaire. This may result in certain incidental direct costs being excluded. Secondly, this study only included fees and expenses incurred by the BRP. There is the possibility that the companies incurred other kinds of expenses that are a direct result of the business rescue, and these expenses may have been paid by the companies directly. Thirdly, this study did not include restructuring costs, for example, the costs of retrenching employees or the costs of shifting production to a new location. Lastly, this study did not include fees and expenses paid by other parties, for example, creditors.

There are three main limitations present in paper 2. Firstly, as with paper 1, this study only considered the perspective of one stakeholder group. Therefore, the findings only reflect a single point of view. Secondly, the responses from participants may be subjected to social desirability bias due to the fact that business rescue has been heavily criticised (Saunders *et al.*, 2009:327). Lastly, although Guest *et al.* (2006:61) state that six to 12 interviews are sufficient for qualitative research, the researcher acknowledges that the number of participants interviewed may limit the generalisability of the findings.

Although the findings of this study has several limitations, this study provides a starting point for future research into the direct and indirect costs of business rescue proceedings in South Africa.

CHAPTER 1:	Introduction	2
CHAPTER 2:	Paper 1	10
CHAPTER 3:	Paper 2	57
CHAPTER 4:	Summary and conclusion	93
CHAPTER 5:	List of references	101

## CHAPTER 5: LIST OF REFERENCES

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## **APPENDIX A**

**- Informed consent form and discussion guide -**



## Consent for participation in an academic research study

### Dept. of Business Management

#### An exploration of the costs associated with business rescue in South Africa

Research conducted by:

Miss. N.V.A. De Abreu (13230817)

Cell: 071 688 5052

Dear participant

You are invited to participate in an academic research study conducted by Nicole De Abreu, a Master's student in Business Management from the Department of Business Management at the University of Pretoria.

The purpose of this qualitative study is to investigate the direct and indirect costs of business rescue proceedings in South Africa.

Please note the following:

- This study involves a semi-structured personal interview. Your name and that of your company will not appear in the final research report and the answers you give during the interview will be treated as strictly confidential. You cannot be identified in person based on the answers you give.
- Your participation in this study is very important to me. You may, however, choose not to participate and you may also stop participating at any time without any negative consequences.
- The interview will take about 60 to 90 minutes of your time.
- The results of the study will be used for academic purposes only and may be published in an academic journal. I will provide you with a summary of the findings on request.
- Please contact my study leader, Dr. W. Rosslyn-Smith, on tel. (012) 420-6364 (e-mail: wesley.rosslyn-smith@up.ac.za) if you have any questions or comments regarding the study.

Please sign the form to indicate that:

- You have read and understand the information provided above.
- You give your consent to participate in the study on a voluntary basis.

\_\_\_\_\_  
Respondent's signature

\_\_\_\_\_  
Date

## **DISCUSSION GUIDE: PAPER 1 AND PAPER 2 INTERVIEW**

### **INTRODUCTION**

Thank you for your willingness to take part in my study. The purpose of this study is to investigate the direct costs and indirect costs of business rescue proceedings in South Africa.

This interview will consist of two sections. The first section will cover the direct costs of business rescue and the second section will cover the indirect costs. During the first section of the interview, we will be doing a semi-structured interview using a card sort. Once we have completed the first section, we will move on to the second section, which will consist of a semi-structured interview. This interview should take approximately 60 to 90 minutes of your time.

As you may have read in the informed consent form, your responses will be kept as strictly confidential and you will never be identified by name when I report the results of the study. Your participation in this study is very important to me. However, participation in this study is voluntary therefore, you are free to stop participating and may withdraw at any time. Before we begin, I kindly ask that you sign this consent form.

I would like to ask your permission to tape record this interview, so I may accurately document the information you convey.

Do you have any questions or concerns before we begin? May I start the interview now?

### **MAIN QUESTIONS: DIRECT COSTS (PAPER 1)**

I would like to start this interview by talking about the possible direct costs of business rescue that I have identified in literature and from analysing various business rescue plans. The direct costs of business rescue are the out-of-pocket expenses that are directly related to administering business rescue proceedings. Direct costs include administrative costs and the fees paid to various professionals.

I have divided these direct costs into four cost categories as can be seen in the diagram (see Figure 6). These cost categories include:

- the BRP fees as prescribed by the Act;
- general disbursements in the form of professional fees;
- general disbursements incurred by the BRP in the discharge of his duties; and
- contingency fees which are also known as the success-based fees.

These costs categories consist of various cost components. We will begin by discussing the cost categories that I have just mentioned.

1. Do you agree with the cost categories that I have identified?

1.1 **If no:** What cost categories would you remove, add or change?

1.2 What is the reason for removing, adding or changing the cost categories?

I have created cards that contain the various direct costs that make up the various cost categories. I will lay them down in a moment. Once I have placed these cards on the table, I would like to ask you to place each cost component, one-by-one, under the correct cost category. As you are placing the cost components:

- I would like to ask you to think out loud and explain why you are placing the component under the specific cost category;
- please also describe what these costs entail;
- please also explain why it is important for companies to incur these costs; and
- I have added another category where you can place cost components that you do not think are part of the direct costs of business rescue.

I would now like to ask you to please fill out the blank cards if you think I have left out any important cost components and place these cards under the correct cost categories. Once again, I would like to ask you to explain why you are placing the component under the specific cost category.

2. Did I leave out any major cost components from the first cost category – that is the BRP hourly fees?
3. Did I leave out any major cost components from the second cost category – that is disbursements in the form of professional fees?
4. Did I leave out any major cost components from the third cost category – that is general disbursements?
5. Did I leave out any major cost components from the last cost category – that is success-based fees?

### **Additional and probing questions**

**Note:** the following questions emerged throughout the interview process and were added to the discussion guide throughout the process.

6. With regards to your **hourly fees**, do you agree with the hourly tariffs prescribed in the Act?
  - 6.1 Do you adjust your hourly fee for inflation?
7. Before you are appointed as a practitioner of a company, do you charge a **commencement fee or a professional initiation fee** for all the work you do prior to your appointment as a practitioner?
  - 7.1 **If yes:** why do you charge this fee?
  - 7.2 **If yes:** what does this fee typically cover?
8. What are your thoughts on the **contingency fees**?
  - 8.1 Which do you agree with?
  - 8.2 Which do you disagree with?
  - 8.3 Why do you disagree with them?
  - 8.4 Why do you think it is important to charge contingency fees?
  - 8.5 How are contingency fees typically calculated?

9. Before you are appointed as a practitioner, do you require the company to make a deposit in a trust with attorneys?
  - 9.1 **If yes:** why do you charge this fee?
  - 9.2 **If yes:** what does this fee typically cover?
  
10. With regards to the **filing for business rescue proceedings**, do you charge that as part of your hourly fees or do you charge a separate fee for that?
  - 10.1 **If separate:** Why do you charge a separate fee for the filing?

## **Closure**

11. Do you think I have left out any important topics or information regarding the direct costs of business rescue?
12. Do you have any questions for me?

That concludes the first section of our interview. I would now like to move on to the second section, where we will be discussing the indirect costs of business rescue.

## **MAIN QUESTIONS: INDIRECT COSTS (PAPER 2)**

For the second part of our interview, I would like to discuss indirect costs. The purpose of this study is to explore the indirect costs of financial distress that companies face, as a consequence of filing for business rescue proceedings in South Africa. Indirect costs are those costs that are not actually paid out as expenses during proceedings. Indirect costs may cause an even faster deterioration of the operating performance of a company that is already in financial distress and as a result, indirect costs may impede the success of a rescue attempt.

## **Introductory questions**

1. In your opinion, what are the indirect costs companies face, as a consequence of filing for business rescue proceedings in South Africa?

1.1 Why do you think this is the case?

1.2 What effect does this have on business rescue proceedings?

**Table 15: Exploratory interview questions**

Indirect cost identified in literature	Exploratory/probing questions
Reputational damage	2. In your opinion, what effect does filing for business rescue proceedings have on a company's reputation? 2.1 Why do you think this is/is not the case? 2.2 What effect does this have on business rescue proceedings?
Decreased sales	3. In your opinion, what effect does filing for business rescue proceedings have on company sales and profitability? 3.1 Why do you think this is/is not the case? 3.2 What effect does this have on business rescue proceedings?
Customer goodwill	4. In your opinion, what effect does business rescue have on customer goodwill? 4.1 Why do you think this is/is not the case? 4.2 What effect does this have on business rescue proceedings? 4.3 Which types of businesses or industries typically experience a loss of customer goodwill? 4.4 How do you, as a practitioner, mitigate a loss of customer goodwill?
Supplier goodwill	5. In your opinion, what effect does business rescue have on supplier goodwill? 5.1 Why do you think this is/is not the case? 5.2 What effect do you think this has on business rescue proceedings? 5.3 Does the practitioner's reputation play any role in supplier goodwill? 5.4 How does the way management acted towards suppliers in the run-up to business rescue affect supplier goodwill? 5.5 How does this affect your job as a practitioner? In other words, what strategies do you use to mitigate the loss of supplier goodwill?
Post-commencement finance (PCF)	6. In your experience, to what extent do companies face challenges in raising PCF during business rescue? 6.1 Why do you think this is/is not the case? 6.2 What are the main reasons for this? 6.3 What effect does a lack of PCF have on business rescue proceedings?
Asset sales	7. In your experience, are assets often sold during business rescue in order to generate cash (examples: assets such as equipment or subsidiaries)? 7.1 <b>If yes:</b> Are assets often sold out of desperation? (Asset sales are defined as desperation if the company/BRP is forced to sell assets it wishes to otherwise retain or that are part of core operations). 7.2 <b>If yes:</b> Are proceeds often less than expected?

Indirect cost identified in literature	Exploratory/probing questions
	7.3 <b>If yes:</b> What type of assets are typically sold during business rescue proceedings? 7.4 <b>If no:</b> Are assets often sold by management before a company goes into business rescue?
Employee morale	8. In your opinion, what effect does business rescue have on employee morale and productivity? (When discussing employee morale, please distinguish between the morale of blue-collar and white-collar employees). 8.1 Why do you think this is/is not the case? 8.2 What effect do you think this has on business rescue proceedings? 8.3 <b>If decrease:</b> How does this affect your job as BRP?
Turnover of management and key employees	9. In your experience, do companies experience a high turnover of key employees during business rescue? 9.1 Why do you think this is/is not the case? 9.2 What effect do you think this has on business rescue proceedings? (positive and negative) 10. <b>If increased turnover:</b> How does this affect your job as BRP? 11. In your experience, do companies experience a high turnover of management? 11.1 Why do you think this is/is not the case? 11.2 What effect do you think this has on business rescue proceedings? (positive and negative)
Opportunity costs	12. In your opinion, do companies often experience costs, in the form of lost opportunities during business rescue proceedings? 12.1 Why do you think this is/is not the case? 12.2 What effect, if any, do lost opportunities have on business rescue proceedings?

## Closure

13. In your opinion, did I leave out any important topics regarding the indirect costs of business rescue?
14. Do you have any questions for me?
15. Are there any business rescue practitioners you could refer me too?
16. What licence do you hold?
17. What is your background?



## **CONCLUSION**

That brings us to the end of our interview today. Thank you again for your time and willingness to share your insights with me. I would like to ask your permission to contact you if I need to clarify any information or if some additional questions arise if that is okay?

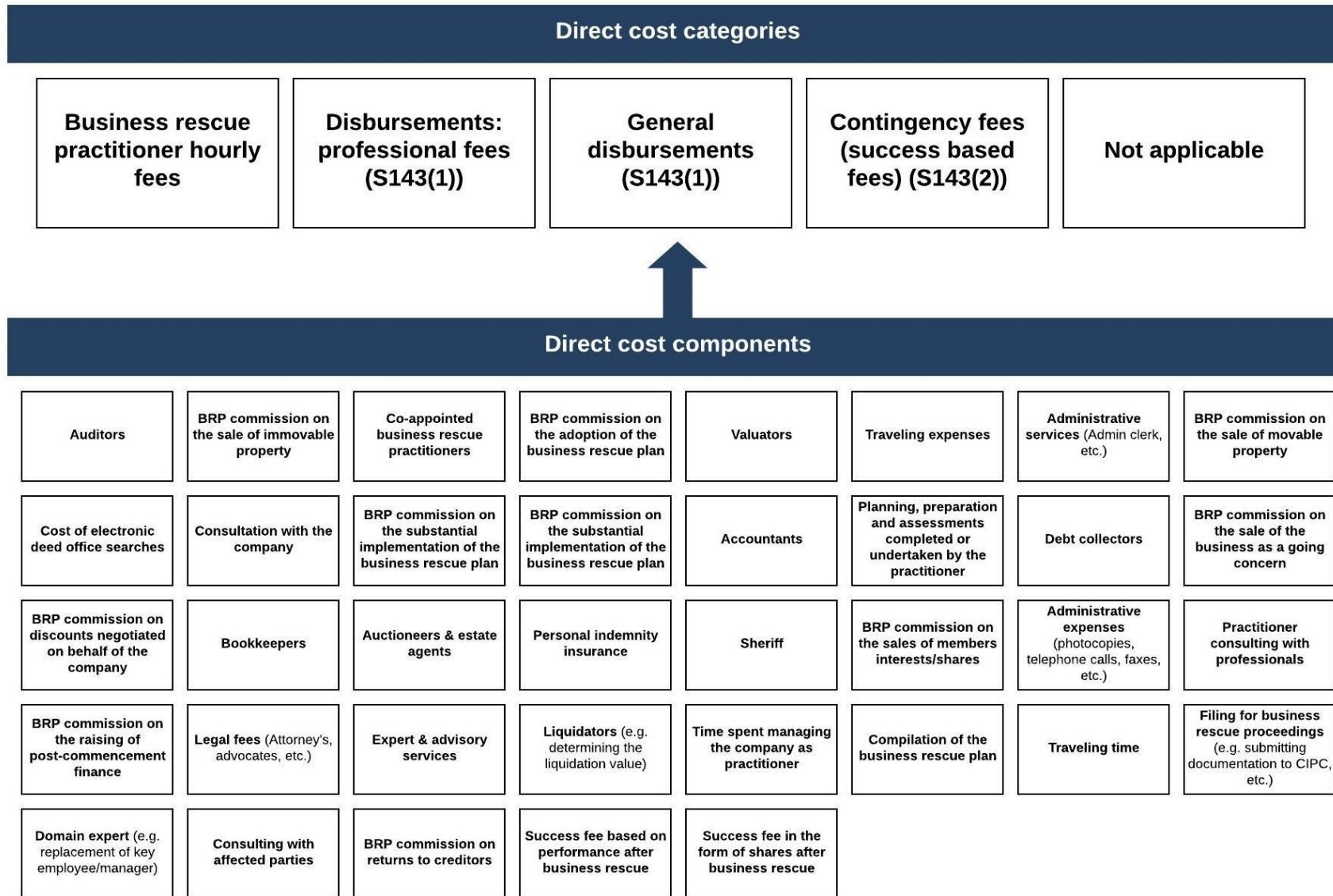
I would like to ask you to take part in the second phase of my study. The second phase will consist of a survey regarding the direct costs of business rescue. The purpose of the survey is to measure the direct costs of business rescue that have been identified in the interview. This will be an online survey conducted over Qualtrics.

For the survey, I would like you to select three companies that were previously under business rescue proceedings. You will then answer a few short questions regarding the costs incurred in each business rescue case. Please note that you will not be required to disclose the names of the companies. Further, I would like to iterate that the information disclosed in the survey is confidential and that all data obtained will be exclusively used for this study. Would you mind if I sent you a link to my survey over the next two/three (few) weeks? (If participant replies yes) Please, may I confirm your email address?

## **CARD SORT DIAGRAM**

Figure 6 displays an example of the card sort. The direct cost categories were placed in the same order for each interview. The direct cost components were placed in a random order below the direct cost categories in each interview.

Figure 6: Card sort example



## **APPENDIX B**

**- Informed consent form and final questionnaire -**

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### Start of Block: Welcome

Welcome \$e://Field/Title. \$m://LastName,

Thank you for agreeing to take part in this important survey.

The purpose of this survey is to **estimate** the direct costs for companies that were previously under business rescue. Please note that this is a **confidential** survey. You will not be identified and the answers you provide will be used for the research purposes of this study only.

Thank you in advance for your thoughtful completion of these questions. I really appreciate your time and effort!

### End of Block: Welcome

---

### Start of Block: Consent for participation

Before you begin, please read the consent form below. If you agree to participate in this study, please sign below to indicate that:

- You have read and understand the information provided below.
  - You give your consent to participate in the study on a voluntary basis.
- 



UNIVERSITEIT VAN PRETORIA  
UNIVERSITY OF PRETORIA  
YUNIBESITHI YA PRETORIA

### Consent for participation in an academic research study

#### Dept. of Business Management

#### An exploration of the costs associated with business rescue in South Africa

Research conducted by:

Miss. N.V.A. De Abreu (13230817)

Cell: 071 688 5052

Dear \$e://Field/Title. \$m://LastName,

You are invited to participate in an academic research study conducted by Nicole De Abreu, a Master's student in Business Management from the Department of Business Management at the University of Pretoria.

The purpose of this survey is to measure the direct costs of business rescue for companies that were previously under business rescue proceedings in South Africa.

Please note the following:

- This study involves a survey. Your name and that of your company will not appear in the final research report and the answers you provide will be treated as strictly **confidential**.
- You are **not** required to disclose the names of any companies.
- Your participation in this study is very important to me. You may, however, choose not to participate and you may also stop participating at any time without any negative consequences.
- Please answer the questions in the questionnaire as completely and honestly as possible.
- The results of the study will be used for academic purposes only and may be published in an academic journal. I will provide you with a summary of the findings on request.
- Please contact my study leader, Dr. W. Rosslyn-Smith, on tel. (012) 420-6364 (e-mail: wesley.rosslyn-smith@up.ac.za) if you have any questions or comments regarding the study.



**End of Block: Consent for participation**

---

**Start of Block: Instructions**

18. Please select up to **three** companies that were previously under business rescue proceedings. Please select companies within the following inclusion and exclusion criteria:
  - **Exclude** any special purpose entities/vehicles (a legal entity created to fulfil narrow, specific or temporary objectives) i.e., companies with the sole objective of housing a single asset; and
  - Only **include** companies with a business rescue plan (whether or not the plan was approved or not approved).
19. You are required to answer questions for **each** company. The survey will consist of questions covering basic company characteristics, and questions regarding the direct costs incurred during proceedings.
20. You are **not** required to provide exact figures. Estimates regarding the direct costs will be sufficient.

**Please answer all the questions related to the companies that you select below.**

---

Please select the number of companies you will provide details on.

End of Block: Instructions

---

Start of Block: Basic info

You have chosen to provide details on [\\$Q5/ChoiceGroup/SelectedChoices](#). This survey will take you approximately [\\$Q5/SelectedChoicesRecode](#) minutes to complete.

End of Block: Basic info

---

Start of Block: Overview

*Display This Question:*

- If Please select the number of companies you will provide details on. = 1 Company*
- Or Please select the number of companies you will provide details on. = 2 Companies*
- Or Please select the number of companies you will provide details on. = 3 Companies*

The following questions relate to the characteristics and the direct costs of your **Company 1** during the time spent in business rescue proceedings.

End of Block: Overview

---

Start of Block: Company 1: Characteristics

*Display This Question:*

- If Please select the number of companies you will provide details on. = 1 Company*
- Or Please select the number of companies you will provide details on. = 2 Companies*
- Or Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the type of business of **Company 1**:

- Closed corporation (1)
  - Private company (2)
  - Public company (3)
  - Non-profit company (4)
- 

*Display This Question:*

- If Please select the number of companies you will provide details on. = 1 Company*
- Or Please select the number of companies you will provide details on. = 2 Companies*
- Or Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the industry sector of **Company 1**:

- Agriculture, hunting, forestry and fishing (1)
- Mining and quarrying (2)
- Manufacturing (3)
- Electricity, gas and water supply (4)
- Construction (5)
- Wholesale and retail trade (6)
- Repair of motor vehicles and personal and household goods (7)
- Hotels and restaurants (8)
- Transport, storage and communication (9)
- Financial intermediation insurance, real estate and business services (10)
- Community, social and personal services (11)
- Other (please specify) (12)

*Display This Question:*

*If Please select the number of companies you will provide details on. = 1 Company  
Or Please select the number of companies you will provide details on. = 2 Companies  
Or Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the duration of business rescue proceedings for **Company 1**:



*Display This Question:*

*If Please select the number of companies you will provide details on. = 1 Company  
Or Please select the number of companies you will provide details on. = 2 Companies  
Or Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the **Public Interest Score** for **Company 1**:

*Display This Question:*

*If Please select the number of companies you will provide details on. = 1 Company  
Or Please select the number of companies you will provide details on. = 2 Companies  
Or Please select the number of companies you will provide details on. = 3 Companies*

Please provide basic company details at the commencement date for **Company 1**:

	Rand
Total assets	<input type="text"/>
Total liabilities	<input type="text"/>
Total turnover	<input type="text"/>

---

*Display This Question:*

*If Please select the number of companies you will provide details on. = 1 Company  
Or Please select the number of companies you will provide details on. = 2 Companies  
Or Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the average number of employees at the commencement date for **Company 1**:

---

*Display This Question:*

*If Please select the number of companies you will provide details on. = 1 Company  
Or Please select the number of companies you will provide details on. = 2 Companies  
Or Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the total number of individuals with direct or indirect beneficial interest in the company e.g. shareholders, at the commencement date for **Company 1**:

**End of Block: Company 1: Characteristics**

---

**Start of Block: Company 1: Direct costs**

*Display This Question:*

*If Please select the number of companies you will provide details on. = 1 Company  
Or Please select the number of companies you will provide details on. = 2 Companies  
Or Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the total business rescue costs for **Company 1**. Total business rescue costs include:

- The basic remuneration of the business rescue practitioner;



- Disbursements in the form of professional fees incurred by the practitioner;
- General disbursements or expenses incurred by the practitioner; and
- Contingency fees, as contemplated in Section 143(2) of the Act.

Rand

Total business rescue costs

*Display This Question:*

*If Please select the number of companies you will provide details on. = 1 Company*

*Or Please select the number of companies you will provide details on. = 2 Companies*

*Or Please select the number of companies you will provide details on. = 3 Companies*

**Approximately** how much did you spend on the following costs for **Company 1**?

Rand

Total business rescue practitioner fees  
(excluding contingency fees)

Total co-appointed business rescue  
practitioner fees

Total contingency fees

*Display This Question:*

*If Please select the number of companies you will provide details on. = 1 Company*

*Or Please select the number of companies you will provide details on. = 2 Companies*

*Or Please select the number of companies you will provide details on. = 3 Companies*

**Approximately** how much did you spend on the following professional fees for **Company 1**?

Rand

Legal fees (e.g. Attorney's, advocates,  
debt collectors, sheriff, etc.)

Liquidators

Valuators

Auctioneers and estate agents

Rand

Bookkeepers, accountants and auditors

Experts and advisory services (e.g.  
Turnaround specialists, domain experts,  
tax experts, metallurgist, etc.)

*Display This Question:*

*If Please select the number of companies you will provide details on. = 1 Company*

*Or Please select the number of companies you will provide details on. = 2 Companies*

*Or Please select the number of companies you will provide details on. = 3 Companies*

**Approximately** how much did you spend on the following costs for **Company 1**?

Rand

Travelling expenses

Personal indemnity insurance

Administrative expenses and services (e.g.  
Admin clerk, photocopies, etc.)

End of Block: Company 1: Direct costs

Start of Block: Overview

*Display This Question:*

*If Please select the number of companies you will provide details on. = 2 Companies*

*Or Please select the number of companies you will provide details on. = 3 Companies*

The following questions relate to the characteristics and the direct costs of your **Company 2** during the time spent in business rescue proceedings.

End of Block: Overview

Start of Block: Company 2: Characteristics

*Display This Question:*

*If Please select the number of companies you will provide details on. = 2 Companies*

*Or Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the type of business of **Company 2**:

Closed corporation (1)

- Private company (2)
- Public company (3)
- Non-profit company (4)

*Display This Question:*

*If Please select the number of companies you will provide details on. = 2 Companies*

*Or Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the industry sector of **Company 2**:

- Agriculture, hunting, forestry and fishing (1)
- Mining and quarrying (2)
- Manufacturing (3)
- Electricity, gas and water supply (4)
- Construction (5)
- Wholesale and retail trade (6)
- Repair of motor vehicles and personal and household goods (7)
- Hotels and restaurants (8)
- Transport, storage and communication (9)
- Financial intermediation insurance, real estate and business services (10)
- Community, social and personal services (11)
- Other (please specify) (12)

*Display This Question:*

*If Please select the number of companies you will provide details on. = 2 Companies*

*Or Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the duration of business rescue proceedings for **Company 2**:



*Display This Question:*

*If Please select the number of companies you will provide details on. = 2 Companies*

*Or Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the **Public Interest Score** for **Company 2**:

---

*Display This Question:*

*If Please select the number of companies you will provide details on. = 2 Companies*

*Or Please select the number of companies you will provide details on. = 3 Companies*

Please provide basic company details at the commencement date for **Company 2**:

	Rand
Total assets	<input type="text"/>
Total liabilities	<input type="text"/>
Total turnover	<input type="text"/>

---

*Display This Question:*

*If Please select the number of companies you will provide details on. = 2 Companies*

*Or Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the average number of employees at the commencement date for **Company 2**:

---

*Display This Question:*

*If Please select the number of companies you will provide details on. = 2 Companies*

*Or Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the total number of individuals with direct or indirect beneficial interest in the company e.g. shareholders, at the commencement date for **Company 2**:

**End of Block: Company 2: Characteristics**

---

**Start of Block: Company 2: Direct costs**

*Display This Question:*

*If Please select the number of companies you will provide details on. = 2 Companies*

*Or Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the total business rescue costs for **Company 2**. Total business rescue costs include:

- The basic remuneration of the business rescue practitioner;
- Disbursements in the form of professional fees incurred by the practitioner;
- General disbursements or expenses incurred by the practitioner; and
- Contingency fees, as contemplated in Section 143(2) of the Act.

Rand

Total business rescue costs

---

*Display This Question:*

*If Please select the number of companies you will provide details on. = 2 Companies*

*Or Please select the number of companies you will provide details on. = 3 Companies*

**Approximately** how much did you spend on the following costs for **Company 2**?

Rand

Total business rescue practitioner fees  
(excluding contingency fees)

Total co-appointed business rescue  
practitioner fees

Total contingency fees

---

*Display This Question:*

*If Please select the number of companies you will provide details on. = 2 Companies*

*Or Please select the number of companies you will provide details on. = 3 Companies*

**Approximately** how much did you spend on the following professional fees for **Company 2**?

Rand

Legal fees (e.g. Attorney's, advocates, debt  
collectors, sheriff, etc.)

Liquidators

Valuators

Auctioneers and estate agents

Rand

Bookkeepers, accountants and auditors

Experts and advisory services (e.g.  
Turnaround specialists, domain experts,  
tax experts, metallurgist, etc.)

*Display This Question:*

*If Please select the number of companies you will provide details on. = 2 Companies*

*Or Please select the number of companies you will provide details on. = 3 Companies*

**Approximately** how much did you spend on the following costs for **Company 2**?

Rand

Travelling expenses

Personal indemnity insurance

Administrative expenses and services (e.g.  
Admin clerk, photocopies, etc.)

**End of Block: Company 2: Direct costs**

**Start of Block: Overview**

*Display This Question:*

*If Please select the number of companies you will provide details on. = 3 Companies*

The following questions relate to the characteristics and the direct costs of your **Company 3** during the time spent in business rescue proceedings.

**End of Block: Overview**

**Start of Block: Company 3: Characteristics**

*Display This Question:*

*If Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the type of business of **Company 3**:

- Closed corporation (1)
- Private company (2)
- Public company (3)
- Non-profit company (4)

---

*Display This Question:*

*If Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the industry sector of **Company 3**:

- Agriculture, hunting, forestry and fishing (1)
- Mining and quarrying (2)
- Manufacturing (3)
- Electricity, gas and water supply (4)
- Construction (5)
- Wholesale and retail trade (6)
- Repair of motor vehicles and personal and household goods (7)
- Hotels and restaurants (8)
- Transport, storage and communication (9)
- Financial intermediation insurance, real estate and business services (10)
- Community, social and personal services (11)
- Other (please specify) (12)

---

*Display This Question:*

*If Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the duration of business rescue proceedings for **Company 3**:



---

*Display This Question:*

*If Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the **Public Interest Score** for **Company 3**:

---

*Display This Question:*

*If Please select the number of companies you will provide details on. = 3 Companies*

Please provide basic company details at the commencement date for **Company 3**:

	Rand
Total assets	<input type="text"/>
Total liabilities	<input type="text"/>
Total turnover	<input type="text"/>

---

*Display This Question:*

*If Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the average number of employees at the commencement date for **Company 3**:

---

*Display This Question:*

*If Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the total number of individuals with direct or indirect beneficial interest in the company e.g. shareholders, at the commencement date for **Company 3**:

**End of Block: Company 3: Characteristics**

---

**Start of Block: Company 3: Direct costs**

*Display This Question:*

*If Please select the number of companies you will provide details on. = 3 Companies*

Please indicate the total business rescue costs for **Company 3**. Total business rescue costs include:

- The basic remuneration of the business rescue practitioner;
- Disbursements in the form of professional fees incurred by the practitioner;
- General disbursements or expenses incurred by the practitioner; and
- Contingency fees, as contemplated in Section 143(2) of the Act.



Rand

Total business rescue costs

*Display This Question:*

*If Please select the number of companies you will provide details on. = 3 Companies*

**Approximately** how much did you spend on the following costs for **Company 3**?

Rand

Total business rescue practitioner fees  
(excluding contingency fees)

Total co-appointed business rescue  
practitioner fees

Total contingency fees

*Display This Question:*

*If Please select the number of companies you will provide details on. = 3 Companies*

**Approximately** how much did you spend on the following professional fees for **Company 3**?

Rand

Legal fees (e.g. Attorney's, advocates, debt  
collectors, sheriff, etc.)

Liquidators

Valuators

Auctioneers and estate agents

Bookkeepers, accountants and auditors

Experts and advisory services (e.g.  
Turnaround specialists, domain experts,  
tax experts, metallurgist, etc.)

*Display This Question:*

*If Please select the number of companies you will provide details on. = 3 Companies*

**Approximately** how much did you spend on the following costs for **Company 3**?

Rand

Travelling expenses

Personal indemnity insurance

Administrative expenses and services (e.g.  
*Admin clerk, photocopies, etc.*)

**End of Block: Company 3: Direct costs**

---

**APPENDIX C**  
**- Card sort data analysis -**

# CARD SORT DATA ANALYSIS

## PHASE ONE

In order to analyse the card sort data, the researcher recorded the results in a component-by-category results matrix. The initial card sort started with 30 cards (direct cost components) and four direct cost categories. New direct cost components emerged during interviews three, five, 10 and 12, resulting in a total of 36 direct cost components. The new direct costs components were the following:

- Interview three:
  - Domain expert.
- Interview five:
  - Consulting with affected parties.
  - Filing for business rescue proceedings (e.g. submitting documentation to CIPC, etc.).
- Interview 10:
  - BRP commission on returns to creditors.
- Interview 12:
  - Success fee based on performance after business rescue.
  - Success fee in the form of shares after business rescue.

Table 16 displays the component-by-category results matrix displaying how all 14 participants grouped the cards into the pre-set categories. The darker the blue, the more times a card appeared in the corresponding category (Spencer, 2018). The first column displays the different cards participants sorted. The first row displays the categories participants used to group the different cards.

**Table 16: Component-by-category results matrix**

<b>Direct cost components</b>	<b>C1</b>	<b>C2</b>	<b>C3</b>	<b>C4</b>	<b>C5</b>
Planning, preparation and assessments completed or undertaken by the practitioner	14/14				
Practitioner consulting with professionals	14/14				
Consultation with the company	14/14				
Time spent managing the company as practitioner	14/14				
Travelling time	13/14				1/14
Compilation of the business rescue plan	14/14				
Co-appointed business rescue practitioners	13/14	1/14			
Legal fees (Attorney's, advocates, etc.)		13/14	1/14		
Sheriff		2/14	4/14		3/14
Sheriff included in legal fees		5/14			
Debt collectors		5/14	3/14		3/14
Debt collectors included in legal fees		3/14			
Cost of electronic deed office searches		1/14	6/14		3/14
Deed office searches included in legal		4/14			
Accountants		11/14	1/14		2/14
Auditors		10/14			4/14
Bookkeepers		8/14	5/14		1/14
Auctioneers & estate agents		8/14	6/14		
Valuators		11/14	3/14		
Liquidators (e.g. determining the liquidation value)		12/14			2/14
Expert & advisory services		13/14	1/14		
Travelling expenses			14/14		
Personal indemnity insurance		2/14	11/14		1/14

<b>Direct cost components</b>	<b>C1</b>	<b>C2</b>	<b>C3</b>	<b>C4</b>	<b>C5</b>
Administrative expenses (photocopies, telephone calls, faxes, etc.)			8/14		6/14
Administrative services (Admin clerk, etc.)		5/14	9/14		
BRP commission on the raising of post-commencement finance				6/14	8/14
BRP commission on discounts negotiated on behalf of the company				2/14	12/14
BRP commission on the adoption of the business rescue plan				11/14	3/14
BRP commission on the substantial implementation of the business rescue plan				13/14	1/14
BRP commission on the sale of members interests/shares				6/14	8/14
BRP commission on the sale of the business as a going concern				10/14	4/14
BRP commission on the sale of immovable property				8/14	6/14
BRP commission on the sale of movable property				7/14	7/14
Domain expert (e.g. replacement of key employee/manager) <b>(interview 3)</b>		6/12	4/12		2/12
Consulting with affected parties <b>(interview 5)</b>	10/10				
Filing for business rescue proceedings (e.g. submitting documentation to CIPC, etc.) <b>(interview 5)</b>	7/10				3/10
BRP commission on returns to creditors <b>(interview 10)</b>				4/5	1/5
Success fee based on performance after business rescue <b>(interview 12)</b>				3/3	
Success fee in the form of shares after business rescue <b>(interview 12)</b>				2/3	1/3

Notes:

C1: Business rescue practitioner hourly fees.

C2: Disbursements: professional fees (S143(1)).

C3: General disbursements (S143(1)).

C4: Contingency fees (success-based fees) (S143(2)).

C5: Not applicable.

## **PHASE TWO**

Table 17 displays a popular placements matrix showing the percentage of participants who sorted each card into the corresponding category (Spencer, 2018). In addition, the cards containing the direct cost components were reordered so that all of the direct cost components with the highest percentages are grouped together in the matrix under each group (Ma, 2010).

**Table 17: Popular placements matrix**

<b>Direct cost components</b>	<b>C1</b>	<b>C2</b>	<b>C3</b>	<b>C4</b>	<b>C5</b>
Planning, preparation and assessments completed or undertaken by the practitioner	100%				
Compilation of the business rescue plan	100%				
Time spent managing the company as practitioner	100%				
Practitioner consulting with professionals	100%				
Consultation with the company	100%				
Consulting with affected parties <b>(interview 5)</b>	100%				
Co-appointed business rescue practitioners	93%	7%			
Travelling time	93%				7%
Filing for business rescue proceedings (e.g. submitting documentation to CIPC, etc.) <b>(interview 5)</b>	70%				30%
Legal fees (Attorney's, advocates, etc.)		93%	7%		
Expert & advisory services		93%	7%		
Liquidators (e.g. determining the liquidation value)		86%			14%
Valuators		79%	21%		
Accountants		79%	7%		14%
Auditors		71%			29%
Debt collectors Debt collectors included in legal fees		36% 21%	21%		21%
Bookkeepers		57%	36%		7%
Auctioneers & estate agents		57%	43%		
Sheriff Sheriff included in legal fees		14% 36%	29%		21%
Domain expert (e.g. replacement of key employee/manager) <b>(interview 3)</b>		50%	33%		17%
Travelling expenses			100%		



<b>Direct cost components</b>	<b>C1</b>	<b>C2</b>	<b>C3</b>	<b>C4</b>	<b>C5</b>
Personal indemnity insurance		14%	79%		7%
Administrative services (Admin clerk, etc.)		36%	64%		
Administrative expenses (photocopies, telephone calls, faxes, etc.)			57%		43%
Cost of electronic deed office searches Deed office searches included in legal		7% 29%	43%		21%
Success fee based on performance after business rescue <b>(interview 12)</b>				100%	
BRP commission on the substantial implementation of the business rescue plan				93%	7%
BRP commission on returns to creditors <b>(interview 10)</b>				80%	20%
BRP commission on the adoption of the business rescue plan				79%	21%
BRP commission on the sale of the business as a going concern				71%	29%
Success fee in the form of shares after business rescue <b>(interview 12)</b>				67%	33%
BRP commission on the sale of immovable property				57%	43%
BRP commission on the sale of movable property				50%	50%
BRP commission on discounts negotiated on behalf of the company				14%	86%
BRP commission on the raising of post-commencement finance				43%	57%
BRP commission on the sale of members interests/shares				43%	57%

Notes:

C1: Business rescue practitioner hourly fees.

C2: Disbursements: professional fees (S143(1)).

C3: General disbursements (S143(1)).

C4: Contingency fees (success-based fees) (S143(2)).

C5: Not applicable.

## PHASE THREE

During the third phase, the researcher renamed several categories and direct cost components based on the interview data. Some components were renamed only to ensure consistency. In addition, several direct cost components were merged or removed based on the interview data, resulting in 32 direct cost components. The following changes were made to the direct cost categories and components:

- The first category, “business rescue practitioner hourly fees”, was renamed to “basic remuneration of the BRP”.
- The second category, “disbursements: professional fees (S143(1))”, was renamed to “Professional fee disbursements (S143(1))”.
- The direct cost category, domain expert was removed and considered under the same cost category as expert and advisory services. According to participants, a domain expert is an expert in a certain field and would typically be brought in to replace a key employee or manager. This expert may be brought in on a temporary basis as part of the team during the rescue proceedings.
- The sheriff and debt collectors were both removed and treated as part of the legal fees cost component as participants indicated that these services would typically be carried out by a firm of attorneys.
- The cost of electronic deed office searches component was removed as participants indicated that these costs are insignificant, and the function is typically carried out by a firm of attorneys.
- “Planning, preparation and assessments completed or undertaken by the practitioner” was renamed to “Planning, preparation and assessments completed or undertaken by the BRP”.
- “Time spent managing the company as practitioner” was renamed to “Time spent managing the company as BRP”.
- “Practitioner consulting with professionals” was renamed to “BRP consulting with professionals”.
- “Consultation with the company” was renamed to “BRP consulting with the company”.

- “Consulting with affected parties” was renamed to “BRP consulting with affected parties”.
- “Co-appointed business rescue practitioners” was renamed to “Co-appointed BRP’s”.
- “Personal indemnity insurance” was renamed to “professional indemnity insurance”.
- “BRP commission on the adoption of the business rescue plan” was renamed to “fee payable on the adoption of the business rescue plan”.
- “BRP commission on the substantial implementation of the business rescue plan” was renamed to “fee payable on the substantial implementation of the business rescue plan”.

Table 18 displays the final popular placements matrix after changes were made.

**Table 18: Final popular placements matrix**

<b>Direct cost components</b>	<b>C1</b>	<b>C2</b>	<b>C3</b>	<b>C4</b>	<b>C5</b>
Planning, preparation and assessments completed or undertaken by the BRP	100%				
Compilation of the business rescue plan	100%				
Time spent managing the company as BRP	100%				
BRP consulting with professionals	100%				
BRP consulting with the company	100%				
BRP consulting with affected parties	100%				
Co-appointed BRP's	93%	7%			
Travelling time	93%				7%
Filing for business rescue proceedings (e.g. submitting documentation to CIPC, etc.)	70%				30%
Legal fees (Attorney's, advocates, etc.)		93%	7%		
Expert and advisory services		93%	7%		
Liquidators (e.g. determining the liquidation value)		86%			14%
Valuators		79%	21%		
Accountants		79%	7%		14%
Auditors		71%			29%
Bookkeepers		57%	36%		7%
Auctioneers and estate agents		57%	43%		
Travelling expenses			100%		
Professional indemnity insurance		14%	79%		7%
Administrative services (Admin clerk, etc.)		36%	64%		
Administrative expenses (photocopies, telephone calls, faxes, etc.)			57%		43%
Fee payable on the adoption of the business rescue plan				79%	21%
Fee payable on the substantial implementation of the business rescue plan				93%	7%

<b>Direct cost components</b>	<b>C1</b>	<b>C2</b>	<b>C3</b>	<b>C4</b>	<b>C5</b>
BRP commission on the sale of the business as a going concern				71%	29%
BRP commission on the sale of movable property				50%	50%
BRP commission on the sale of immovable property				57%	43%
BRP commission on returns to creditors				80%	20%
Success fee based on performance after business rescue				100%	
Success fee in the form of shares after business rescue				67%	33%
BRP commission on the raising of post-commencement finance				43%	57%
BRP commission on the sale of members interests and shares				43%	57%
BRP commission on discounts negotiated on behalf of the company				14%	86%

Notes:

C1: Basic remuneration of the BRP (S143(1)).

C2: Professional fee disbursements (S143(1)).

C3: General disbursements (S143(1)).

C4: Contingency fees (success-based fees) (S143(2)).

C5: Not applicable.

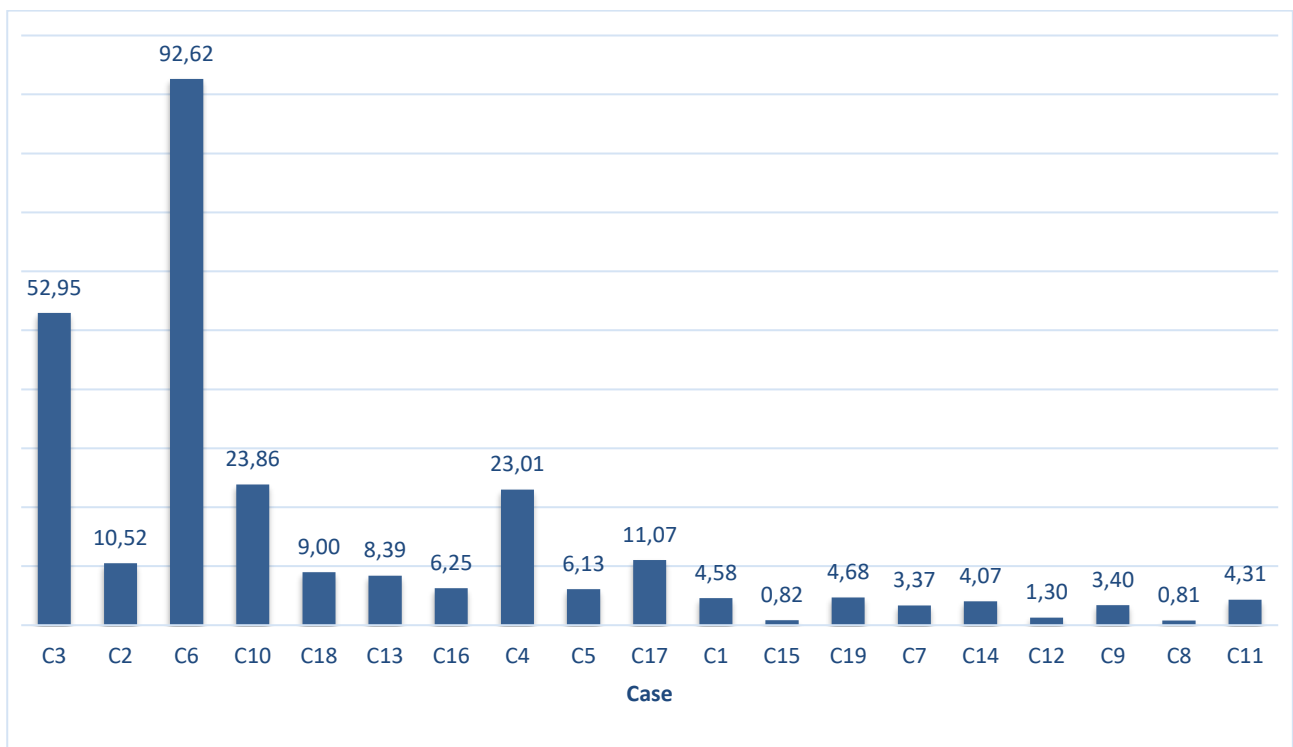
**APPENDIX D**  
**- Descriptive statistics -**

## DESCRIPTIVE STATISTICS FOR NOMINAL AND RATIO LEVEL DATA

### DESCRIPTIVE STATISTICS FOR RATIO DATA

Figure 7 displays direct costs as a percentage of total asset value (%DC/TA) for all 19 companies in the study. The cases are arranged from the smallest to the largest companies. The %DC/TA range from a minimum of 0.81% to a maximum of 92.62%, with a mean ratio of 14.27%.

**Figure 7: Direct costs as a percentage of total asset value at the commencement date ( $n = 19$ )**



Upon visual inspection of Figure 7, it appears that direct costs decrease as a percentage of company size. Therefore, this suggests that a scale effect may be present (Betker, 1997; Ferris & Lawless, 2000:656).

## **APPENDIX E**

**- Test results: statistical assumptions -**



## HYPOTHESES TESTS

### TESTS FOR HYPOTHESIS 1 (H<sub>1</sub>) AND HYPOTHESIS 2 (H<sub>2</sub>):

#### Statistical test for the assumption of normality

Table 19 reports the results of the Kolmogorov-Smirnov test for normality regarding duration, company size and direct costs of business rescue proceedings.

**Table 19: Kolmogorov-Smirnov test for the variables tested in H<sub>1</sub> and H<sub>2</sub>**

	Kolmogorov-Smirnov <sup>a</sup>		
	Statistic	df	p-value
Total duration	0.271	19	0.001
Total company size	0.367	19	0.000
Total direct costs	0.370	19	0.000

#### Notes:

a = Lilliefors significance correction.

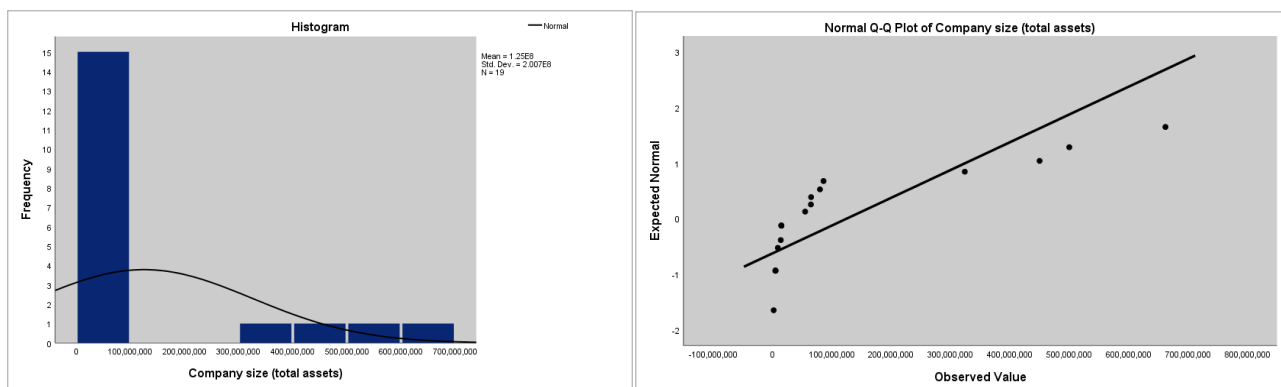
df = Degrees of freedom.

The *p*-value for duration, company size and direct costs is 0.001, 0.000, and 0.000 respectively. These *p*-values are smaller than the chosen level of significance (i.e., 0.05), therefore, this indicates that the three variables do not have normal distributions.

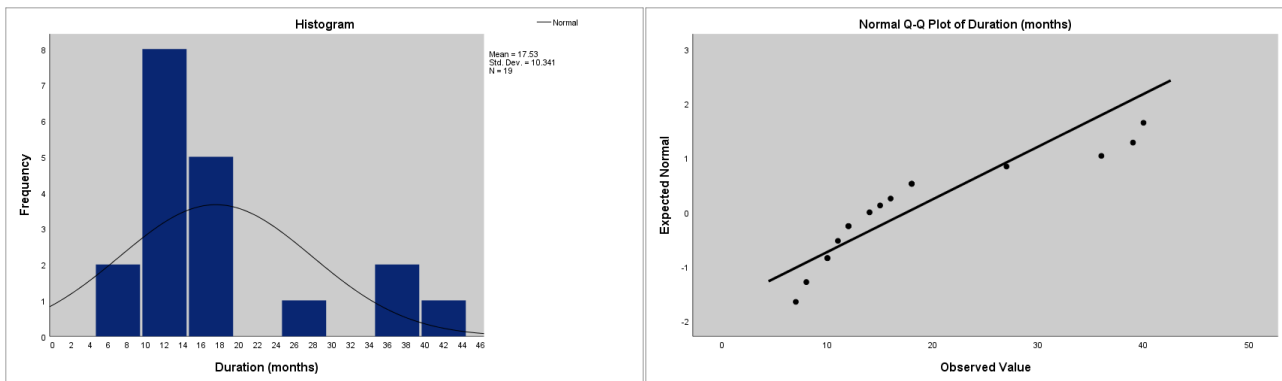
#### Graphical tests for the assumption of normality

Figures 8, 9 and 10 display histograms and normal probability plots ('Normal Q-Q plots') representing the distribution for company size, duration and direct costs.

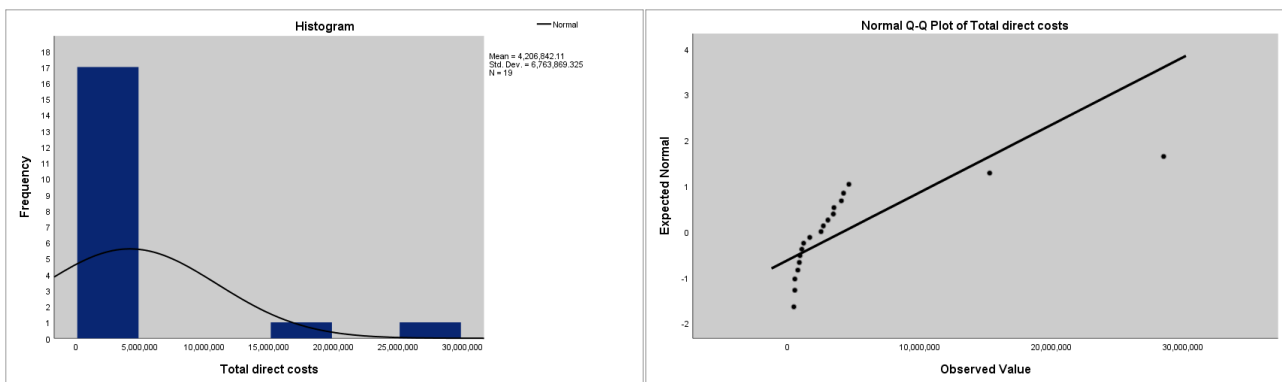
**Figure 8: Histogram and normal probability plot representing the distribution total company size**



**Figure 9: Histogram and normal probability plot representing the distribution total duration**



**Figure 10: Histogram and normal probability plot representing the distribution total direct costs**

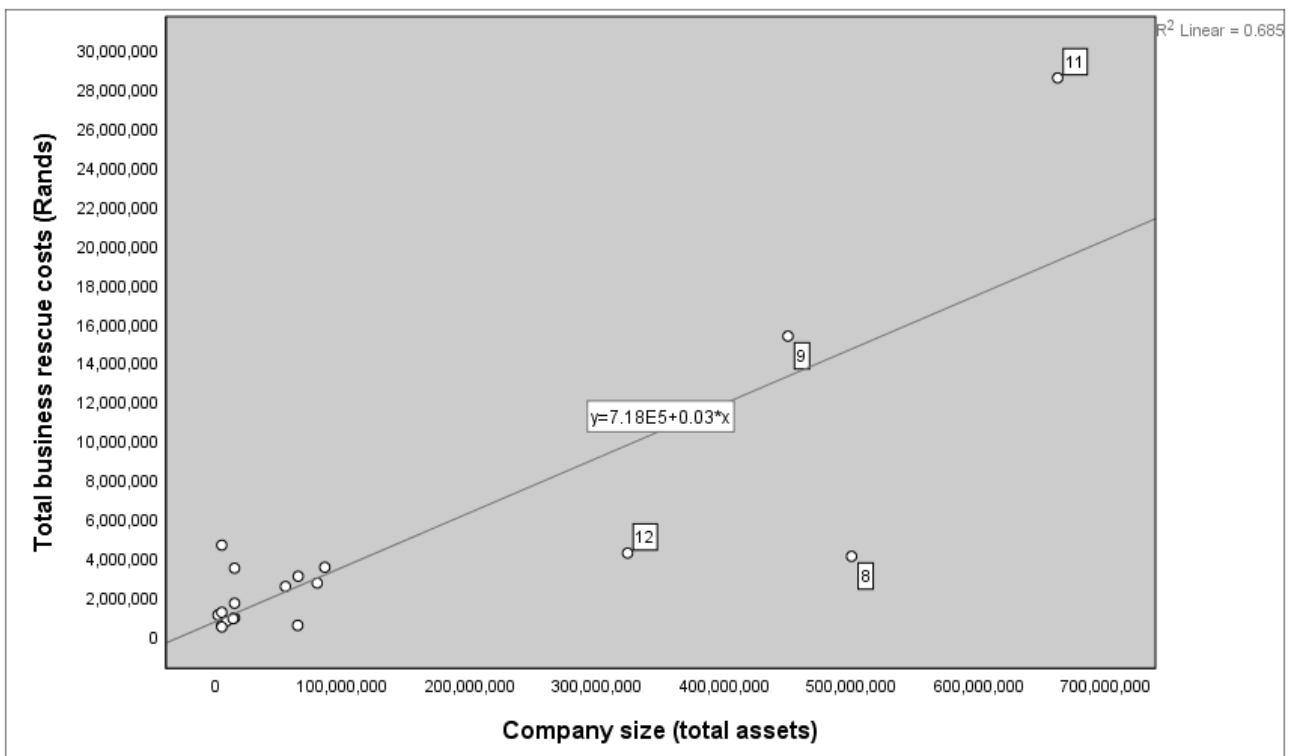


Figures 8, 9 and 10 confirm that the three variables do not have normal distributions. Therefore, the Spearman’s rank order correlation, the non-parametric alternative to the Pearson’s product moment correlation, was used to test  $H_1$  and  $H_2$ .

**Graphical test for the assumption of linearity for the variables tested in Hypothesis 1**

Figure 11 displays a scatter plot representing the linear relationship between the two variables, company size and direct costs, to be tested in Hypothesis 1.

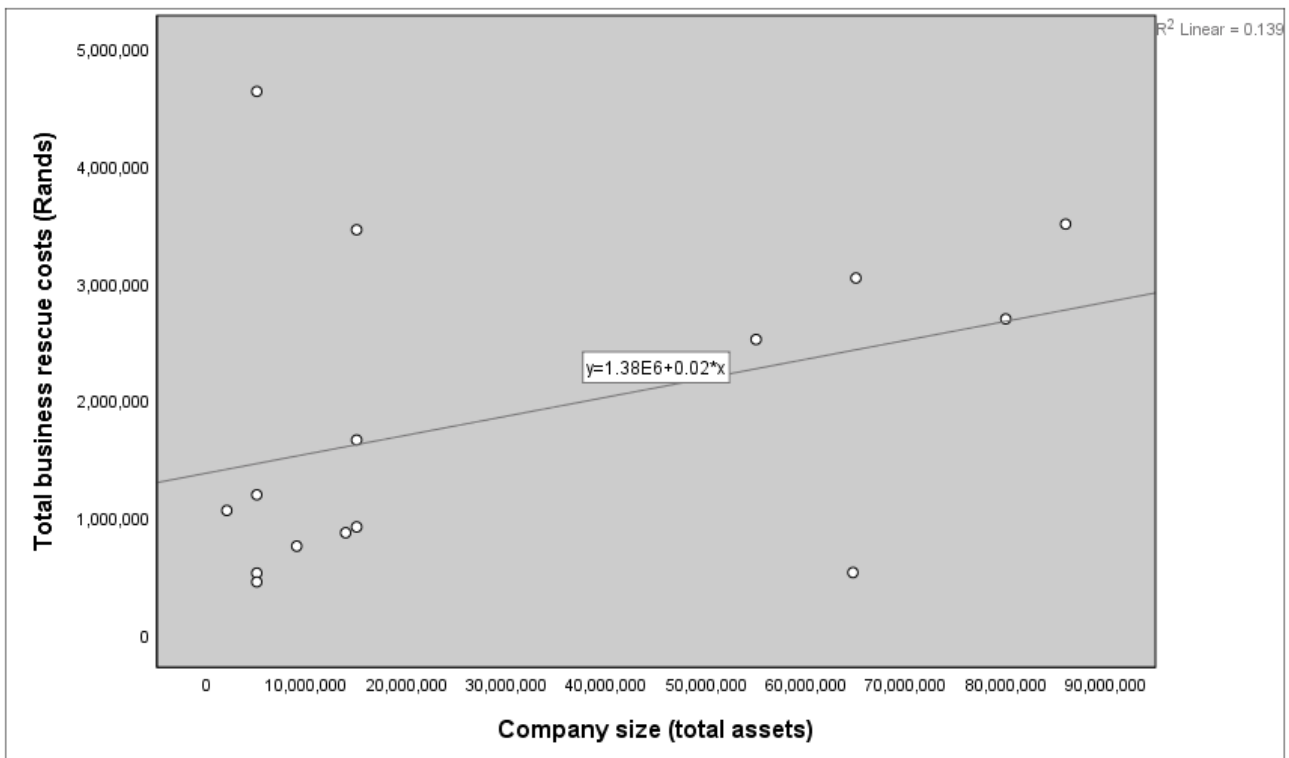
**Figure 11: Scatter plot showing the correlation between total direct costs and company size**



An inspection of the scatter plot provides information on both the direction of the relationship (positive or negative) and the strength of the relationship (Pallant, 2007:121). The fact that the regression line has a definite positive slope indicates that there is a positive relationship and also suggests that the relationship is linear. However, upon inspection of the scatter plot, it appears that there are outliers (cases 8, 9, 11 and 12) within the data set. Outliers may have a dramatic effect on the correlation coefficient ( $r$  value), especially in small samples (Pallant, 2007:121). Pallant (2007:121) recommends removing outliers to reduce the effect they have on the  $r$  value. However, according to Cooper and Schindler (2014:497) and Tanner (2012), an advantage of Spearman's rank order correlation is that outliers that were troublesome before ranking no longer pose a threat since the largest number in the distribution is equal to the sample size.

Figure 12 displays a scatter plot representing the relationship between the two variables to be tested in Hypothesis 1, where the outliers have been removed.

**Figure 12: Scatter plot showing the correlation between total direct costs and company size where the outliers have been removed**

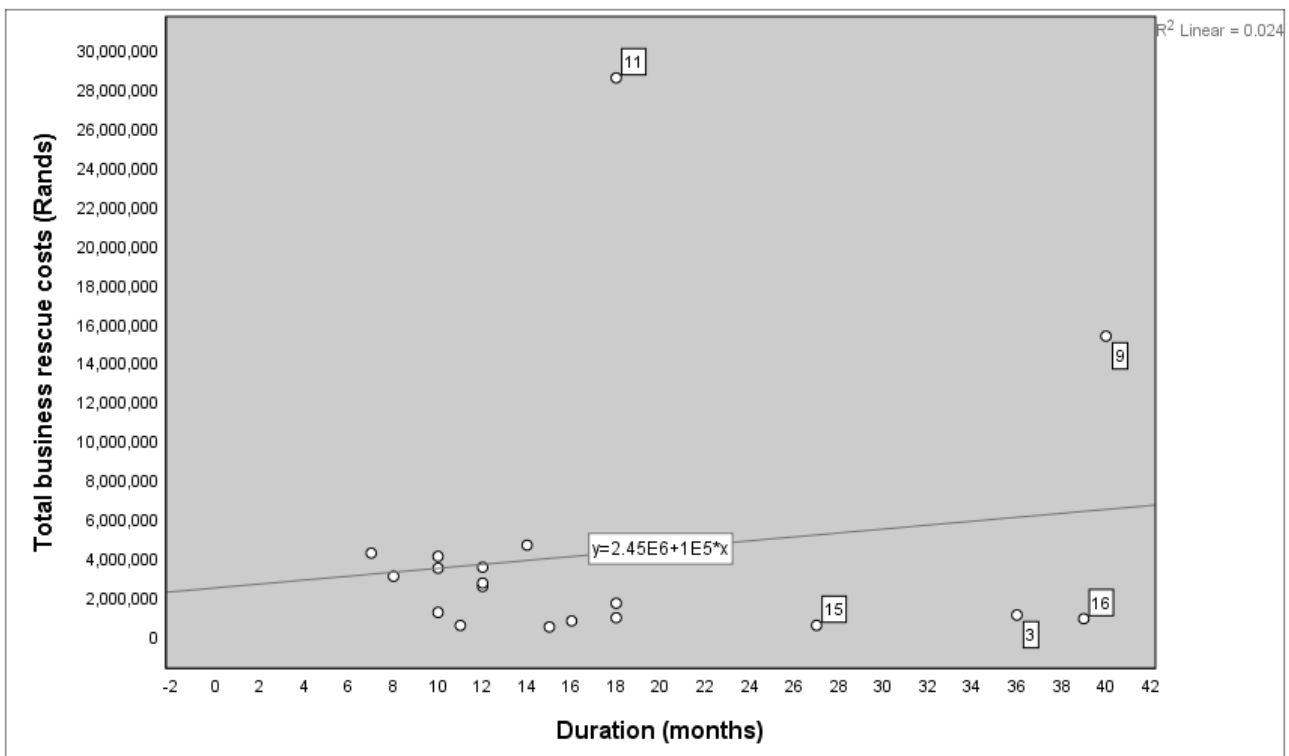


The fact that the regression line has a definite positive slope indicates that there is a positive relationship and also suggests that the relationship is linear. However, once outliers were removed, the scatter plot in Figure 12 shows that there is a weak relationship between the two variables. Therefore, it appears that the outliers may have a dramatic effect on the correlation coefficient ( $r$  value) (Pallant, 2007:121). Pallant (2007:121) recommends removing outliers to reduce the effect they have on the  $r$  value. As a result, the researcher tested Hypothesis 1 twice, once with the outliers and once where the outliers were removed.

**Graphical test for the assumption of linearity for the variables tested in Hypothesis 2**

Figure 13 displays a scatter plot representing the linear relationship between the two variables, duration and direct costs, to be tested in Hypothesis 2.

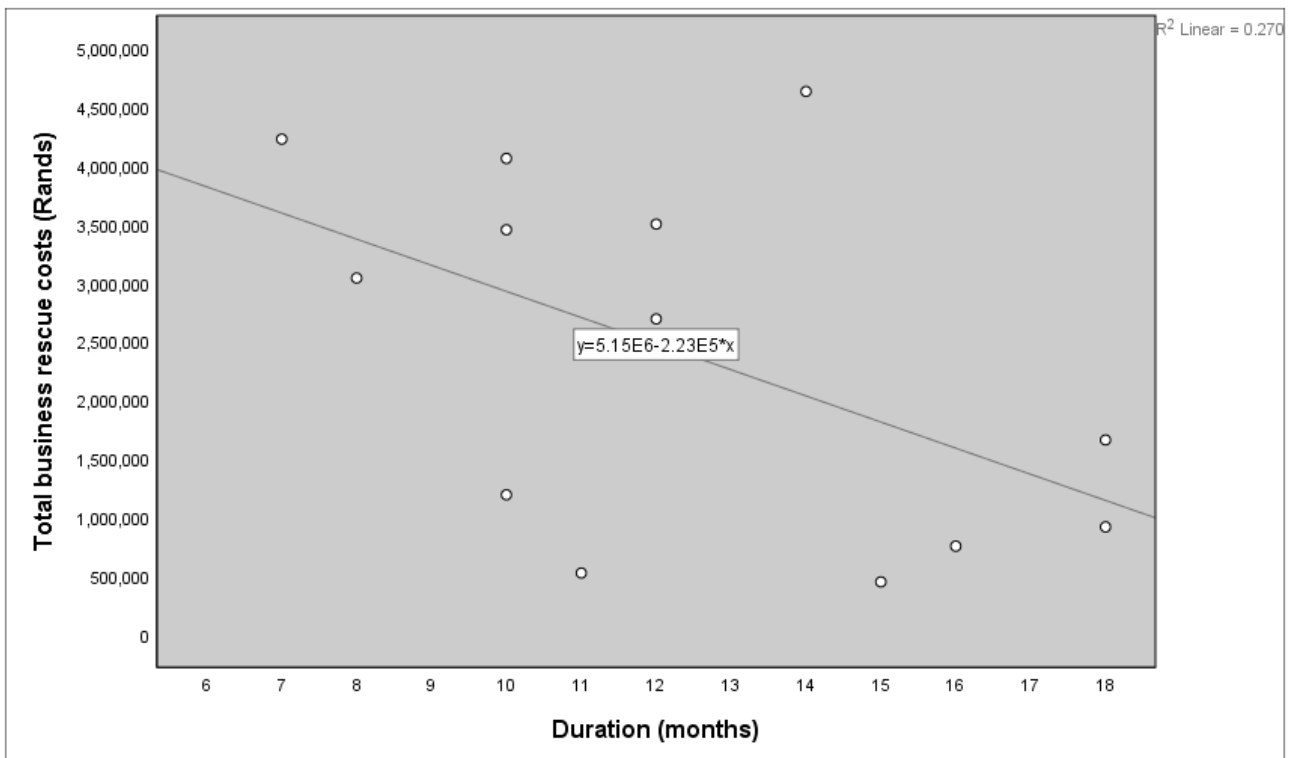
Figure 13: Scatter plot showing the correlation between total direct costs and duration



The fact that the regression line has a definite positive slope indicates that there is a positive relationship linear relationship, albeit a weak one. Upon inspection of the scatter plot, it appears that there are outliers (cases 3, 9, 11, 15 and 16) within the data set. Outliers may have a dramatic effect on the correlation coefficient ( $r$  value), especially in small samples (Pallant, 2007:121). Pallant (2007:121) recommends removing outliers to reduce the effect they have on the  $r$  value. However, according to Cooper and Schindler (2014:497) and Tanner (2012), an advantage of Spearman's rank order correlation is that outliers that were troublesome before ranking, distort the resulting coefficient less than in a Pearson Correlation since the largest number in the distribution is equal to the sample size.

Figure 14 displays a scatter plot representing the relationship between the two variables to be tested in Hypothesis 2, where the outliers have been removed.

**Figure 14: Scatter plot showing the correlation between total direct costs and duration where the outliers have been removed**



The fact that the regression line has a negative slope indicates that there is a negative relationship and also suggests that the relationship is linear. However, once outliers were removed, the scatter plot in Figure 14 shows that there is a negative relationship between the two variables. Therefore, it appears that the outliers may have a dramatic effect on the correlation coefficient ( $r$  value) (Pallant, 2007:121). Pallant (2007:121) recommends removing outliers to reduce the effect they have on the  $r$  value. As a result, the researcher tested Hypothesis 1 twice, once with the outliers and once where the outliers were removed.

## **APPENDIX F**

**- Table linking codes to final themes and sub-themes (paper 1) -**

Table 20 to Table 23 shows how the data were coded to the individual cost components and cost categories. Raw data extracts accompany these codes.

**Table 20: The link between the cost components and direct cost category, the basic remuneration of the BRP (S143(1))**

Codes	Raw data extracts
Travelling time	<p>“...not something I’ve charged. You either doing the work or you not doing the work. You charge for the time you work...Let’s say if it’s a 10-hour travel and it’s a plane trip somewhere then...no I normally don’t charge that, but that’s me. I don’t think that’s normal.” (BRP10)</p> <p>“The thing with travelling time, you know those hours that you are spending in the car travelling to your clients is time you could be spending on another client. You know inevitably you want to bill eight hours of your day or however many hours you spend doing work-related activities, you do want to bill that time.” (BRP12)</p>
Filing for business rescue proceedings	<p>“No, I charge my hourly rate [for filing for BR]. So, I don’t charge a separate fee for that. I mean to prepare those docs it’s so simple...people charge hefty fees for that.” (BRP05)</p> <p>“So, filing the business rescue proceedings, that’s actually something that belongs to the company its self. But because you...we were attacked in business rescue in terms of Section 129(3), the practitioners tend to do that now as well now. Okay, so I’m doing the same.” (BRP09)</p> <p>“...filing for business rescue, we also charge a fee for doing that and I think all practitioners should do that because it immediately shows the clients willingness to save the company. If it’s free, everyone’s going to do it and if you ask a fee for it, it shows commitment by the client, because he is willing to pay money to make this thing work.” (BRP13)</p> <p>“This is generally not done by the practitioner, this is done by a professional or this is normally the company that does this, which commences it. But I wouldn’t see it as a business rescue expense [filing]. No, I try and avoid. I have helped fill out forms and the likes but that I typically wouldn’t charge for that. If you do the thing incorrectly and the rescue bombs out, they going to come knock on your door. So rather get the company and their advisors to do it and to the extent that they need assistance then we would use them...because we have a separate attorney for the business rescue practitioner and possibly for the company.” (BRP14)</p>
Hourly rate is low	<p>“The rate in the regulations for business rescue practitioners were established essentially in 2008, pre-2008. So those rates are 10 years plus old. Never have been escalated and there is no provision for escalation or what index that can be used to escalate those rates. Now if you consider the degree of risk that a business rescue practitioner has to take by law and the degree of complexity in a business rescue. You have started thinking of a bench mark, what benchmark do you use for professional services hourly rate in that whole universe today. And let’s take a simple example. Let’s take a senior partner from a good law firm. Senior partners in a good law firm will give you an hourly rate of anywhere from 5000 and 9000 rand an hour. What risk do they take? They’ve got no risk, zip risk! So, he is professional, he is an attorney in a very small field, in one little booklet from a million little booklets of law usually, and he knows a lot about a little bit and then a hell of a lot about a small amount of stuff and he charges that kind of money per hour. Along comes a business rescue practitioner, and we are charging 1753, 39 excluding VAT per hour. So, it’s 2000 inclusive of VAT. These other professionals do not take any of the risk. Our hourly rate needs to be in line with the kind of the work we do and the kind of the risk we take.” (BRP03)</p> <p>“If I get appointed in a company with a PI score below a 100. Purely in accordance with the Act, I’m expected to work for R 1250 including VAT. My hourly rate as an attorney, is double that. Why would I do business rescue? It’s just not worth it because I have got the same number of hours in a day. So, if I don’t have the incentive of a contingency fee, I would never take an</p>



Codes	Raw data extracts
	<p>appointment in a small or medium sized company, if I have to stick to the fees as currently prescribed by the regulations in the Act.” (BRP04)</p> <p>“Well, we have done that as well [Increased fees with the consent of creditors]. I’m an attorney by education and in fact also a practising attorney. Gentlemen or ladies of my equal years of experience in practice charge four to four and a half thousand rand an hour. I can’t charge that. I don’t think the fee is commensurate to the experience and seniority of people. I think it’s...in fact, it’s not commensurate at all. So, in instances, again where it’s justifiable, I believe it is appropriate for your fee to be adjusted appropriately.” (BRP11)</p> <p>“Because the hourly rates are not necessarily enough to attract competent people and highly skilled people to the industry. The industry needs highly skilled people and these people need a complete well-rounded skillset and the hourly rates are not necessarily enough to do that. You look at what you could earn if you take 1250 rand for example and times it by 180 hours, it’s about 200 thousand rand a month. As a lawyer you could be charging out at 2500 rand an hour you know as opposed to 1250 so you could be billing 400 thousand rand a month instead of 200 thousand rand a month. So that’s why contingency fees are important and apart from that it’s very important, I think, to make...to give the practitioner his...the practitioners earning have to be linked to the success of the company. It’s very important because that’s what motivates to make it successful. If you just getting paid an hourly fee you not necessarily motivated to fix the company. So, it must definitely...I think contingency fees are extremely important, very, very important.” (BRP12)</p>
Increase hourly rate: inflation	<p>“So, what’s happening now, most practitioners that I know are just taking 6% inflation adjusted per year...I’ve considered it and I actually don’t have a problem with it. Because it’s fair for the effort that they are putting in and there should be an annual adjustment because there is an annual adjustment on everything. So, I think 6% is at the low end of the spectrum. So, I cannot fault any practitioner that actually does an annual adjustment from 2011 from when it was promulgated, not from 2008 when the Act came into being. I would say that’s the right thing to do.” (BRP04)</p>
Increase hourly rate: contingency fees	<p>“So, they [BRPs] are adjusting their fees, but it’s not in terms of the statutory allowance. So, what you have to do, is you have to adjust your fees in terms of Section 143(2). So, you have to go to creditors and shareholders and get their approval and by their approval you can increase your rate that you get paid on an hourly basis. But it actually sits in here [contingency], legally. You can’t just do it unilaterally. You have to go through a Section 143 meeting called with creditors and shareholders and you need 50 per cent plus vote of each and then you are allowed to increase your fees.” (BRP06)</p> <p>“...when we did Company E, it’s a fairly large one, we didn’t go on a success-based fee of getting a huge profit but because it was a very complex assignment we asked them to double the fee. So instead of the R 2000 an hour we asked for R 4000 an hour on substantial implementation. So, the fee would be R 3500 an hour effectively with VAT would come to R 4000 an hour. The Act sets out R 2000 an hour for a big job but its roughly R 1750 plus VAT it gets you close to R 2000.” (BRP07)</p> <p>“So what we’ll do is, conditional on the holding of the first meeting of the creditors, if that meeting is convened and held correctly within the correct time lines and time frames so that rescue commences...because you know if you commence it and you don’t notify, you don’t hold the meetings, you don’t do...rescue can be ended. So conditional on it being started correctly and in the correct time lines and everything and that meeting happening on time, we then ask creditors to approve an increase in our rate. So, it falls into the same contingency based fee but it’s just done differently and that is because even at the 1750 base hourly rate um that is less than what a first year audit clerk charges for example so we rebase that to a normal rate. And depending on the matter and depending on how we structured the whole fee that would be three or five thousand rand an hour. So, we’ll just bump it up as we go.” (BRP10)</p>

Codes	Raw data extracts
	<p>“We don’t adjust it for inflation it’s just too...it kind of goes against what the law says. The law says these are the fees so you kind of have to charge what the Companies Act says. We just prefer to compensate ourselves in terms of contingency fees...by charging contingency fees...another contingency fee I didn’t mention is doubling of the hourly rate. So, you can go, as part of your business rescue plan, you say that on approval of this plan we will affectively double our hourly rate or triple it or whatever and you can apply it in retrospect as well. So, if you started the business rescue on the first of January and the plan only gets approved on the 28th of May then you can say, once it’s approved, you can charge those fees in retrospect. So affectively as soon as it’s adopted, then you can get the difference paid out. So, I think it’s quite a good way of adjusting your rate you know, kind of charging what you think is a fair hourly rate...the creditors at the end of the day for them to vote on the plan really just have to agree to your hourly rate you’re proposing. They got the choice on whether to accept it or to say no or to negotiate.” (BRP12)</p>
Deposit	<p>“...its more that you can’t see where the cash is going to come from so the...it isn’t so much to pay the business rescue practitioner, it’s to pay all of these things. If you can’t pay all of these things you can’t rescue the company. So, if somebody says listen I’m going to put some cash into the company so that you get to the end and at the end of it I as a shareholder or a major lender get a better transaction. That’s part of my initial analysis. So, if I see they going to put some money in, I’m good. If they not and I can see that all of these expenses are going to rack up and there’s no way to pay them, then I’m going to walk away.” (BRP06)</p> <p>“To pay the practitioners fee. So, it’s covering our expenses because this is a risky business. You are going into a business that’s in distress and you don’t know if they’ve got cash, so you take a deposit.” (BRP08)</p> <p>“As a general rule I would want the company to pay a deposit that covers my fee up to the first meeting of the creditors. Because at that point, the first meeting of the creditors may result to place the company into liquidation. so, for me that’s the first chunk of the deposit, then I want to keep the deposit there until the rescue process is finished so that I’ve got a liquidity security blanket, so I can do all these other expenses. I don’t want to take those costs on my own balance sheet.” (BRP09)</p> <p>“What we typically do, depending on the position of the company, is we take an upfront deposit, a security deposit. So, it’s not income to us, it’s held in our bank account or in an attorney’s trust account as security in case any of the fees during the rescue aren’t paid and we can dip into that deposit. At the end of the rescue, you hand that deposit back. But what you often find is when you terminate rescue, there is still work that a practitioner does afterwards, for which there is no payment. So, what we going to be looking at going forward is to word our remuneration agreement that we keep that deposit for six months after termination and all the work we do after that we deduct from the deposit and then the balance gets paid. Because there is actually a lot of work post termination because for everybody to find their feet, they come and talk to the practitioner.” (BRP14)</p>
Once-off initiation fee	<p>“We do take a deposit. We take an advanced payment. So, we say, like we are doing a matter at the moment, a mine which went to court. And we said to them if you want us to take up the matter there’s three things you pay us. You pay us R 250 000 non-refundable initiation fee. That’s for all the work we do prior to our appointment for which we cannot charge under the Act. Because you can only charge under the Act once you are appointed. So, we charge that, and if for any reason we are not appointed, that money you don’t get it back. Then we charge a 250 000 deposit, and we charge that in advance. And every week, we do a time sheet and an invoice, and we top it up monthly. And then you also pay 100 000 into a lawyer’s trust account as a deposit against possible liquidation. So, should we have to liquidate, that will be used to file for liquidation.” (BRP01)</p>

Codes	Raw data extracts
	“And it’s not uncommon. There’s numerous practitioners that charge that. Practitioner A charges initiations that are like a wounded buffalo. There are some practitioners that are shameless. They will put in like 5 million and it’s ridiculous.” (BRP01)

**Table 21: The link between the cost components and direct cost category, professional fee disbursements (S143(1))**

Cost component	Raw data extract
Legal fees	<p>“I always, always use lawyers. I only do big rescues; I don’t do the smaller ones. When you find a company in business rescue, the first thing you will uncover is that the mess is about as twice as big as they have disclosed to you. And every time you turn a rock over there is something else that’s underneath it that is ugly. So there are inevitably agreements that need to be redrawn; there’s a section of the Act, section 136 where you are required to suspend parts of contracts and so that happens; you have to renegotiate certain agreements; there are a number of disputes that arise with your suppliers or your customers and those need to be resolved legally and of course you need to draw up the business rescue plan and make sure that sits in place. Lots of work.” (BRP06)</p> <p>“Now here you got two sets of legal fees. You get your business rescue practitioners attorney. So, I’ve got an attorney looking after my own stuff. Let’s say his name is John. Now John looks at my interest in the business rescue. So, somebody attacks the plan, I use John. I entered into a contract with him and it’s in my remuneration agreement that I’m going to have an attorney and the cost of this attorney is going to be paid by the company. So, I would say it’s then under this general disbursements. But then if the company needs a lawyer, he will go to the choice of the directors. You can’t mix the two because then your independence is then under question. There’s a lot of case law that says that...So this is what legal is, legal is you got two different sets of cost. You got a practitioner cost and you got a company cost and that must be clearly distinguished.” (BRP09)</p> <p>“In every rescue you need an attorney and advocate on board sometimes. Mainly because, well it’s getting better, but creditors don’t understand how rescue works. So, you get lots of noise, [for example] “but I’ve got reservation of ownership” when it doesn’t apply, and you’ve got to investigate each one carefully. So legal fees are probably the biggest professional fee disbursement.” (BRP10)</p>
Accountants, auditors and bookkeepers	<p>“Your accountant remains important for your plan, you need to do at least three-year cash flow projections and balance sheet, you need to do repayment schedules. So, there’s a lot of accounting work that goes into it.” (BRP05)</p> <p>“Because you know what happens in a business rescue, the practitioner doesn’t have the time to get involved in the nitty gritty day-to-day affairs but depending on how good their own supporting staff are of the company in business rescue, you may want to bring in a person or two to support them and it’s at a lower rate so...” (BRP07)</p> <p>“Now depending on...the professional fees are always a difficult situation because it depends on what the status of the company is when you take it. Have you got up to date balance sheets, even up to date trial balances, not necessarily audited financials or whatever the case may be. So that’s where the bookkeeper comes in. It’s usually an in-house bookkeeper. If you haven’t got an in-house bookkeeper, then obviously you are going to appoint someone full time. So, it’s not cost to the practitioner per say. What I use in those instances, I will use accountants, outside accountants to vet what I’ve got there, to make sure that I validate the information. It’s basically the data integrity test. Okay so to check my data integrity, I’ll get an accountant from the outside and that’s going to be part of my professional fees.” (BRP09)</p>
Auctioneers and estate agents	<p>“...let’s say the likelihood of a practitioner being able to dispose of the goods effectively within the business rescue environment is actually quite small. So, what would typically happen is the</p>

Cost component	Raw data extract
	<p>business rescue practitioner would be in the position...let's take a practical example. As business rescue practitioner I would have the assets valued. I would try and sell it out of hand for the best possible price. But because of time pressure and the need for cash flow, if we don't achieve that in a relatively short period of time, the auctioneers would have to come in and they would have to sell the assets. Or on the alternative, buy everything as a batch at the value or higher value determined by the valuers." (BRP04)</p>
Valuators	<p>"I would say in most instances it's advisable to make use of a valuator. The reason being is that is the practitioners back stop...because the Act provides for the practitioner to sell within the business rescue environment, I'm of the view that there needs to be a benchmark against which the practitioner sells. That benchmark gets provided by the valuers. so, I'm only comfortable to dispose of an asset if I've received an independent valuation as to the value of the asset. Then if I sell the asset at the same or a higher value that what it's been valued at, then I can give independent proof that I have sold it at the right price. If I don't have that and I sell it, how can anybody determine if I have sold it at a fair price and I think the practitioner leaves himself open to attack if he does not follow that. So, in my view, it's a very important part of the entire business rescue process." (BRP04)</p> <p>"Valuators is also very important for the liquidation scenario and to calculate the returns to creditors in terms of the liquidation." (BRP13)</p>
Liquidators	<p>"Always! Always independently. As a practitioner I shouldn't be doing it at all. What if my views are biased by the way I want the plan to be. I can't do that, so I have it independently done." (BRP03)</p> <p>"I never do those accounts myself [L&amp;D account]. When you prepare your plan and your documentation and presentation, you need to understand that the guys that listen to you are clever they not stupid. They've gone through liquidations and all related issues many times over, they have been around the block. So if you put something on a screen or paper you need to be able to defend it and you need to be able to qualify and one of the queries is usually "but how do we know you just not trying to bullshit us in calculating as low as possible return on liquidation, just to persuade us to not go to liquidation". So that would be a valid argument had I not used an external professional. I give them the information, I give them the asset register, the valuation of assets, I give him the creditors list and I gave him all the security. And he prepares this so the assumptions he uses to calculate the estimated return on sale of assets, is his in his professional opinion, not mine. Now you can defend your calculations because I use an external person and I pay him for his services. So, it's as simple as that. So that, always I will never do the calculations myself." (BRP05)</p> <p>"...somebody who is an expert in determining your liquidation value, an independent determination...which of course is not a requirement of the Act, so the incurring of this cost is perhaps not necessary, certainly isn't necessary, but is convenient sometimes in order to have an independent view on determination because a practitioner should actually be able to do this calculation by himself so it's a convenience but it would be a professional fee assuming that the person is doing it as a professional." (BRP11)</p> <p>"You have too [use an external party to calculate the LQ dividend] because the Act says that it's got to be independent." (BRP14)</p>
Expert and advisory services	<p>"Depends on the matter. If it's a complex mining issue for example you might need a mining engineer to come in and help. As a practitioner we are not experts on business, on all businesses. But what we are, are experts on rescue and how to put a rescue plan together. So, if it's a retailer you might get a retail expert to come in a just review the trading, make sure that what the guys are telling you are correct." (BRP10)</p> <p>"Expert and advisory I mean ja the purpose of the practitioner is to spearhead the turnaround. He's, in our opinion, not expected to do everything and creditors don't understand that. They want you to be an expert in all fields when you not and I don't understand why they would think that. I mean your job is CEO, they CEO doesn't do everything, he makes sure everything gets</p>

Cost component	Raw data extract
	done and that part they don't understand. So very important, expert and advisory services, definitely." (BRP13)

**Table 22: The link between the cost components and direct cost category, general disbursements (S143(1))**

Cost component	Raw data extract
Travelling expenses	<p>"Then you have your general disbursements which is your travelling, toll, parking, flights and all of that." (BRP05)</p> <p>"Your travelling expenses, your living out expenses, your subsistence and travelling. In other words, your flights, your vehicle hire, your meals and refreshments." (BRP05)</p>
Professional indemnity insurance	<p>"The PI cover basically covers you if the wheels come off and it is shown that you as a practitioner have been negligent and they want to take you to the cleaners. It's actually very limited in its cover and in what it covers. Um, but we do take out, and often it is insisted on by the company and its legal advisors that the BRP take out PI cover as well. And we say that we have to take out PI cover, but you are paying for it not us. I've got like a small flat line PI cover which I pay myself. Which is far less than for what I need for some cases. Some cases I have to take out a PI cover of a 100 million-200 million rand. I can't afford to pay those premiums." (BRP03)</p> <p>"Well I do think it's something that should be charged to be honest because it is quite substantial. It is a big investment that we make. We pay about 150 thousand a year." (BRP07)</p> <p>"We charge it case by case. Build it into the engagement letter and the company must agree to pay the cost of it. And that's required because our normal business PI insurance does exclude business rescue. So, we have to case by case go and get cover depending on what we need." (BRP10)</p>
Administrative expenses	<p>"I don't charge for that, I'm not a lawyer. So that doesn't even come on here, it's not applicable...Just by the way I think it's nonsense." (BRP03)</p> <p>"We go into extreme detail in our billing. We count the phone calls and the time. We allocate specific phone calls...for instance I would use my cell phone a lot and Assistant A takes my cell phone once a week. She goes through all my calls and she allocates it to the specific project and confirms with me; who it was, what it was for, was it for a project or not and then allocates that...we allocate the photocopies and all of that. Obviously, we have certain levels of expenses." (BRP05)</p> <p>"Admin expenses like photocopies and telephone calls, I never charge for. I think a practitioner is entitled to it, but I never do it." (BRP14)</p>
Administrative services	<p>"Sometimes I bring people in and I just make a team but usually I would say...most of the time I use the company and its people. I will use the PA and whoever is there and prepared to come in and help." (BRP03)</p> <p>"Assistant A that sits here has been with me for five years now. She under understands the process and she understands the legislative environment. She understands the risks involved and how extremely important it is to keep...to stick to the timelines and communicate properly towards creditors and to answer queries. That all counts toward their feeling and their perceived...how they feel about you as practitioner, your support and obviously that directly flows through to the company." (BRP05)</p> <p>"...very important to have administrative services. It will save a lot of money for the company if instead of the practitioner doing the minutes and the notices, he's got admin staff that maybe charge half the rate or a quarter thereof." (BRP13)</p>

**Table 23: The link between the cost components and direct cost category, contingency fees (success-based fees) (S143(2))**

Cost component	Raw data extract
<p>Fee payable on the adoption of the business rescue plan</p>	<p>“I’m not crazy about that one because it’s not about the implementation on the plan. The contingency fees should all be about the implementation of the plan, the success of the implementation. In my mind this creates a conflict of interest for the business rescue practitioner because often...so they build in a contingency fee for when the business rescue plan gets accepted then when they propose the plan to creditors, the creditors might come up with unreasonable demands for the business rescue plan. If those unreasonable demands get accepted by the practitioner, if the practitioner says yes that’s fine I agree to you demand in order to get the business rescue plan approved, then the impact of that decision might adversely prejudice the implementation of the plan. So, he is agreeing to unreasonable demands from the creditors to get the plan adopted but after the adoption, because of the unreasonable demands, it’s much more difficult to implement the plan successfully. So that’s why I don’t agree with that.” (BRP12)</p> <p>“I don’t have much problem with that provided that the requirements for substantial implementation are also set out properly and that they then have to stay on board until those have been met. So yes, it is part of the job and the Act actually refers to the adoption of the plan as criteria for a possible contingency fee. So, I don’t have a problem with that, many people say, “but then he just pushes to get the plan adopted and then he leaves and the whole thing just falls over again”. So, if you structure your objectives for substantial implementation well, then that’s not a problem.” (BRP13)</p>
<p>Fee payable on the substantial implementation of the business rescue plan</p>	<p>“Because this entails that you do everything in your power to make sure your plan is voted in and adhered to. So, the practitioner does what it needs to do and then you are paid a commission when everything is done and dusted. You first need to render your full service and creditors need to be satisfied that everything is sorted, payments have been made and then you get a commission for basically saving the company. That’s what it boils down too.” (BRP05)</p> <p>“I also don’t have a problem with that. The concerns, no there are very few concerns in that regard. Depends on what your definition on substantial implementation is. If it’s an easy rescue and you have defined your substantial implementation criteria well then, I don’t have a problem with it but if it’s vague, you know the guy might leave and take his commission or success fee before the actual turnaround may be vested. So that’s a little bit of a concern but I don’t have a problem with that either.” (BRP13)</p>
<p>BRP commission on the sale of the business as a going concern</p>	<p>“Commission on the sale of a business as a going concern, I’m not sure, I think you are paid to do that.” (BRP01)</p> <p>“...there may be value in that. I mean if it was in liquidation and the liquidator sold it, it would normally be 10 percent. So, there is scope to say that look “I’ve helped you nurse this business back to health and I want a 3 percent commission” you know something like that.” (BRP07)</p> <p>“This one, the commission on the sale of the business as a going concern, it’s not as simple as that but I think it would fit in as a success fee but its...sometimes you don’t just get a percentage of the transaction, you can structure that similar to the other one, you get a percentage of the value add. But the simple way is actually just to do it as a percentage of the entire parcel because it gets a bit complicated to try and put it into the remuneration agreement.” (BRP14)</p>
<p>BRP commission on the sale of movable property</p>	<p>“...when we did the Company H’s business rescue, which is a managed wind down, I got the valuers in, in the end we had an auction and goods were sold. We didn’t take any commission on that specific transaction because the auctioneer had already taken commission to realise the costs. So, the practitioner is remunerated as part of his hourly fee for his participation in that. I would also not charge that.” (BRP04)</p> <p>“...The moment you get remunerated for doing those types of things, its incentive to do it whether it’s required or not. I just don’t feel comfortable with that.” (BRP05)</p>

Cost component	Raw data extract
	<p>“...especially if you have a wind down, if you not saving the business and you going into structured wind down then perhaps there isn’t cash in the business and then you say listen “I don’t know whether I’m going to work one hour or a 100 hours, let’s just peg it then everybody knows what they in for”. Because the positive of that is that your numbers are exact. You know if I say to creditors okay I’m going to sell the assets of the company and I’m still going to charge my hourly rate, there is no incentive for me to do it quickly, I’ll just keep on trying for two years and charge my time. But if I say to them okay I will sell it, but I will charge a percentage then they know I’m going to sell it for X, I’m going to be paid Y and they are getting the difference. So I think in those instances especially, its justifiable, very much justifiable and likewise if you have a plan that sees the company continuing and you do have a success fee based on it, again for creditors to know it’s not a percentage based on something that is uncertain...you peg a number, they know what they in for, you get it and its done.” (BRP11)</p>
BRP commission on the sale of immovable property	<p>“I feel there is an argument to be made by the practitioner, to earn commission on the sale of members interests and to earn commission on the sale of immovable property in so far as he is the effective cause of that transaction. So, let’s elaborate on that with regards to immovable property. If the business rescue practitioner appoints an estate agent to sell a property, I don’t believe that there’s a basis for him to double dip because the estate agent is getting a commission. However, if he is the effective cause, then he is entitled to his commission. So, to me that’s the first error where there’s a slight difference kicking in.” (BRP04)</p> <p>“How do you then decide...if I were not remunerated to sell a specific asset as opposed to being remunerated for selling that asset...obviously I will steer towards selling it. Is it a critical business asset and the question will be will you truthfully answer that question when you know you can pocket a million bucks if you sold that asset. You’d probably say no, no, no we can get along with the assets we have, unfortunately its human nature.” (BRP05)</p> <p>“...we normally only do that when we are winding a company down in business rescue...So, if it’s just an ongoing business and we are selling a property, then it’s less acceptable to charge a commission on the sale of immovable property but if you are winding the company down or partially winding it down then absolutely.” (BRP12)</p>
BRP commission on returns to creditors	<p>“It links your remuneration to the payment of the creditor, so the creditors have to be paid in order for you to get paid. So that’s why I really like that idea. Ultimately all the creditors really want is to get money right, they want to get their money back whether is 10 cents, 50 cents or a 100 cents in the rand so therefore if you propose that to the creditors, that for every time they get paid one rand and you get paid five cents or whatever, they will like that.” (BRP12)</p> <p>“So it’s sort of an incentive to a practitioner to do his best to get the highest value for the creditors which is counter intuitive to the lowest value for the company but the company is only the client and we need to make the company survive so that it can pay its creditors back and it can keep the employees employed. So, it’s just a little bit of a different approach to that type of commission structure.” (BRP13)</p> <p>“It’s the improvement on what they would get had there been a liquidation. So, it’s the value add, the up lift on the liquidation dividend.” (BRP14)</p>
Success fee based on performance after business rescue	<p>“Let’s start with payments after the rescue, if that is part of your contingency fee and the idea of rescue is a long-term turnaround of the company then I don’t see a problem with it. Once again if the creditors are happy with it. So, you can say I’m going to work for my hourly rate, we going to fix this thing, take it out of rescue and then it’s going to do this but because of what I’ve done here it’s going to take off. So, I have no reason to think that that’s inappropriate to say “when I took over here the share price was R10 a share over the next five years, because of what I’ve implemented, it’s going to go up to R150 a share and for that I should be remunerated on the growth of the share price. I think that’s actually quite an interesting approach to contingency fees.” (BRP13)</p>

Cost component	Raw data extract
	<p>“Well not necessarily the shares. Because what, I haven’t done it yet, but what I think is feasible and it shows your commitment, you can say okay...the projections show you going to earn a profit of a R 100 next year to the extent that you exceed that R 100 I want a percentage of that excess. So, I think that’s fair because the fact that you’ve gone and done a business rescue has actually resulted in it being able to achieve those surpluses, so you should be able to share in that. But it’s not based on the performance of the share price because I think that will have a conflict. But if it’s the performance of the company itself and a percentage of their profits or a percentage of revenue or something.” (BRP14)</p>
<p>Success fee in the form of shares after business rescue</p>	<p>“They spoke a lot there at the TMA that it’s going to impair your independence if you are given shares. But the general consensus was, if you are given shares after the rescue, then its fine and I don’t see it as a problem. Once again if the creditors know about it and they approve then there’s no reason to think that it’s inappropriate. So, if your deal says 10 percent shareholding will be given to the practitioner if certain share price targets are met, then ja 100 percent I don’t have a problem with that.” (BRP12)</p> <p>“I think there is a conflict, whether it’s before or after. Because if it’s after you know that you getting it but if it’s a totally separate thing after you have terminated rescue, then its fine but it’s highly unlikely to be agreed post, all the discussions would happen during so I think there is a conflict...if you know you going to be getting shares, you want to reduce the debt in the company. Whereas the whole process is to optimise the recovery for the creditors.” (BRP14)</p>
<p>BRP commission on the raising of post-commencement finance</p>	<p>“I do not agree with that in so far the BRP raises post commencement finance from a current shareholder that there should be any kind of commission payable. So, if it was me, I would say you are not allowed to do that so it’s not applicable.” (BRP04)</p> <p>“Could be [prejudice creditors] because they are paying more for finance than they need to. So, as I said, I understand why it’s done and I understand there’s a business doing it, but it’s not the BRP’s business. His business is to lower it as much...having said that it’s really, really, really difficult.” (BRP08)</p> <p>“You see your problem with that is...let’s say it’s a nice commission on funding, who are the funders out there? You have got a lot of loan sharks, not banks. Will the banks lend money to business rescue? No! Who’s going to lend the money to business rescue? The loan sharks. You borrow money from the loan sharks, you pocket the commission, you put in the substantial implementation, you walk away, and who has got the problem? The company has got the problem. So, there’s a lot of debate still going on about charging raising fees for the money or to sell a building or to do this or whatever. Because what happens now is...maybe it just needs to be regulated, the fee structure on your contingencies” (BRP09)</p>
<p>BRP commission on the sale of members interest and shares</p>	<p>“So, it could be a sale of shares transactions, so it could be an M&amp;A. So, within that context as a sale of business, in other words a sale of shares and claims in the business, there could be not a commission, but a contingency based fee. So, I’ll classify this as not a commission, but a success fee if one gets that done properly and right and according to pre-defined things. Then you can have a success fee on a successful sale.” (BRP03)</p> <p>“...unless that is part of the absolute strategy of the business rescue and then you can shape it that way. For instance, if there is a 93 percent shareholder, and you want to get rid of that shareholder or that shareholder says get me out, then it’s a different story.” (BRP03)</p> <p>“Well I’m selling something that doesn’t belong to the company. This is the disposal of shares, which is an asset of somebody else. It’s not applicable, that’s not a cost. You understand why I’m saying that? That is not a fee that is either in terms of the Act or a success-based fee. This can only be a separate contractual arrangement with either the member or shareholder. So that would fall outside of the ambit of remuneration.” (BRP11)</p> <p>“I think there’s a potential conflict here because obviously the plan is, or the business rescue is aimed...or managed by creditors. And if you now getting a commission on the sale of shares you</p>



Cost component	Raw data extract
	would...to increase the value of the shares you would reduce the recovery by the creditors, so you get a bigger commission by nailing the creditors.” (BRP14)
BRP commission on discounts negotiated on behalf of the company	<p>“BRP commission on discounts negotiated (Laughter) on behalf of the company, creditors hate this especially. You know if you compromise a creditor and get a commission based on the compromise you’ve achieved. The fact is the creditor pays for your...they already compromising X percentage and now the company actually then remunerates you for not paying them. It doesn’t make sense. So, we never do this. Creditors will mostly, unless it’s a small company where they don’t understand what’s going on, they will not allow it. If the bank is involved they will immediately inform all the other creditors and say “no, we will not vote for this” but it’s a contingency fee that I have never done.” (BRP05)</p> <p>“BRP commission on discounts negotiated on behalf of the company, now this is just...do you have a section here for illegal?...It’s rubbish. It’s your job, you should get commission for it. I know guys do it, its rubbish.” (BRP11)</p> <p>“...that’s an interesting one hey that’s a very interesting one. I don’t really like it and I’ll tell you why, because then they...the business rescue practitioner should be negotiating discounts anyway. So, he shouldn’t be charging specific fees on specific discounts negotiated...he should be negotiating discounts and those discounts will hopefully translate into the company being rescued so then the fees that he earns should be when the company gets rescued and not just on the discounts that he has negotiated.” (BRP12)</p>

## **APPENDIX G**

**- Table linking codes to final themes and sub-themes (paper 2) -**

Table 24 to Table 29 shows how codes were assigned to the raw data extracts. The tables further display the grouping of codes into sub-themes, and then the grouping of the sub-themes into the main themes, namely, the sources of indirect costs.

**Table 24: The link between the codes, sub-themes and the indirect cost source, the loss of customer goodwill**

Sub-themes	Codes	Raw data extracts
Challenges faced with customers	Consequence: Decreased sales	"...but I think in general there will be a reduction in sales, in general, and consequently a reduction in profit because your fixed costs are not going to go down. And business rescue simply introduces additional variable costs. So, your profit is further depressed." (BRP01)
	Consequence: Cash flow	"A decrease in sales is inevitably going to result in a decrease in profit or an increase in the loss that you are making. So, it's going to adversely impact your cash flow. But ultimately a drop in sales impacts your profitability and increases your losses or decreases your profit." (BRP12)
	Consequence: Take advantage	"Customers also take advantage by not paying your debts on time now, they think that you are in trouble, so they don't have to. Assuming they still buying from you." (BRP07)
	Reason: Reducing risk	"...it makes him uncomfortable about the situation in that he now needs to think of ways to limit the risk involved with you not making it through the rescue process and it is then often easier to when you find an alternative service provider to just go with them and say "sorry guys I don't know whether you will be here next month and I need to make sure that my stuff is moved from one place to another and I'm going to go with them now because they are not in rescue and they have a good reputation and sorry" and that is then the end of your business because if you lose your clients then there's no hope of rescuing you." (BRP13)
	Loyalty	"Customer goodwill is amazingly robust. If you have a company that's well established with good customers, you will find that they don't head for the hills that quickly or that easily. They will support the company. If they can understand what's happening and they have comfort in the process, in the management and the BRP, customers will stick around. They have a lot of questions, a lot of questions, "are we assured of supply", but generally customers are also...they not married to you, there isn't a ring in the glove box, but there's loyalty, there's a huge amount of loyalty." (BRP03) "At the initial phase there is concern but both customers and suppliers tend to be fairly loyal I think. I think there is an initial shock and once your customers and suppliers have assessed how it may impact them and they may have taken the necessary precautions around that, then they tend to be cooperative." (BRP07)
Do not interrupt supply	"As long as they get their goods there's no problem. Don't interrupt the supply." (BRP09) "...if you can't supply one part he is not going to buy the entire order. So, you don't just lose the sales on that one part, you lose the entire order. So, you need to be able to convince them that that's not going to happen." (BRP13)	

Sub-themes	Codes	Raw data extracts
Factors influencing customer goodwill	Competitor reactions	<p>“Because the business rescue process is so transparent, your competitors can get a hold of the business rescue plan and know exactly what the state of your business is and kind of take advantage of your weaknesses by going for your customers. So, it could affect your sales, you know you could lose some key customers.” (BRP07)</p> <p>“The next one you’ve got is that your market position is weakened so your competitor activity becomes heightened. So, if you are perceived to be a weak player in the market, your competitors will very soon tell your customers that you shouldn’t be doing business with them because you know they in business rescue and they are going out of business soon. So, your continuity of supply in your customer base becomes a problem, impacting on revenue.” (BRP08)</p>
	BRP skills	<p>“Again, it depends on how you manage it and that comes back to the practitioner’s ability to build relationships and maintain relationships and the practitioner’s ability to implement the right systems and procedures immediately when he steps into the project...” (BRP05)</p> <p>“But all companies go through that dip and that’s one of the key functions of a rescue practitioner, is to make sure you don’t go into that dip. So, you know exactly who your customers are. A lot of people put emphasis on your creditors, get this creditor to vote for your plan. That’s not important, it’s really not because you already ring fenced them, the Act ring fenced them. It’s no concern of yours right. Your concern is to maintain the business, and who’s that? That’s your customer. So, to me it’s more important right at the beginning to go and see your customers.” (BRP09)</p>
	Customer knowledge	<p>“Because you not legally obliged to notify all your customers and them not, strictly speaking, being affected parties in terms of the definition. Many companies would comply with the requirements of the Act but don’t notify their customers. So, they don’t necessarily lose that goodwill with the customers, but they lose that goodwill with the suppliers.” (BRP04)</p>
	Depends on industry and product	<p>“It depends on the industry sector.” (BRP03)</p> <p>“I think it’s very much product dependent.” (BRP04)</p>
	Industry: Contracting & construction	<p>“However, if you are a construction company and you need to be awarded a tender for a project that’s going to take 10 months, and the market knows that in business rescue you might not get the supply of product. You not going to get that tender. So, I think it’s very much determined on whether it’s a cash sale business or whether it’s a service business over an extended period of time. That would drive it to the level of importance attached to business rescue.” (BRP04)</p> <p>“...going to something like a construction company, yes if you are in business rescue you are definitely not going to get a construction contract” (BRP04)</p>
	Industry: Retail	<p>“Retailer B went into rescue and our sales performance went up in the stores and I don’t know quite how that worked but if you track it you can see that more customers were going into the store. Now I don’t know whether that’s because its name was in the press more...but there was no sort of customer-focused indirect cost.” (BRP10)</p>

Sub-themes	Codes	Raw data extracts
		“Ones where you actually are face-to-face with your customers, let’s say for instance a convenience store or a supermarket, it’s not going to affect them that much. A guy is going to walk through the door and if the shelves are full he will keep on coming back. As soon as the shelves become less full he is going to start realising that there’s a problem and he might go somewhere else.” (BRP13)
	Product: Commodities	“If you are a price tacker, then your sales are your sales. Price takers produce a commodity like gold and manganese. You’re a price taker, the market will pay you whatever the market is paying everybody else. And they will buy everything that you produce.” (BRP03) “If its commoditised then they’ll say well that’s fine if [John] doesn’t send it then I can replace it in a week, it’s not a big deal.” (BRP06)
	Product: Components	“If I’m creating engines which somebody else puts into their vehicles which they then sell, they very reluctant to place orders with me because they don’t know that I’m going to deliver. So, if somebody is putting together whatever it is that they are constructing, whatever they sell, they plan way ahead...If I don’t supply my engines, then their business is at risk. So, to the extent that I become a component of somebody else’s production line, there’s a very big impact on customers. To the extent that the customer is indifferent, and they can get my supply from anyone, then they not too fussed.” (BRP06)
	Product: Consumer goods	“If the business is FMCG related, less so [loss of goodwill].” (BRP08) “You know if you supply consumer products, the guys that buy that consumer product wants X amount of product from you and usually you manufacture more than is actually in demand because you can keep that buffer, stock, whatever. So that’s not a big impact on it.” (BRP09)
	Product: Products with enduring benefits	“If its cash sales you can still run it as is, subject to that you don’t have a guarantee attached to it. If you have a guarantee attached to the cash sale, then they might go to the opposition.” (BRP04) “Exactly [for warranties] and after sales services. That can affect you. If the product is dependent on after sales services and you’re under business rescue, why would you now go buy there, you can go buy it somewhere else.” (BRP07)

**Table 25: The link between the codes, sub-themes and the indirect cost source, the loss of supplier goodwill**

Sub-themes	Code	Raw data extracts
Challenges faced with suppliers	Challenge (bank): Increase interest rates	“Banks increase their interest rates because you are now high risk to them.” (BRP09) “...all the banks turn and hit you with penalty interest immediately when you commence rescue.” (BRP10)
	Challenge (bank): Withdraw facilities	“...the bank froze the account immediately. We convinced them to open a new account, but then it took us two weeks to get statements on the old accounts so that we can say “these deposits are post-rescue deposits and you have to give them to us”. Sometimes the bank refuses to give them to us then you have to go to court for an urgent application to compel them to act.” (BRP10)

Sub-themes	Code	Raw data extracts
		<p>“(sigh) financiers withdrawing their facilities, whether it be loan facilities, overdrafts, cancelation of vehicle and asset finance agreements. That’s also going to largely impede on the reasonable prospect of rescue” (BRP13)</p>
	<p>Challenge: Increased charges</p>	<p>“But quite often you pay a premium until they are satisfied that you are through your issues. So that can be a cost, a payment premium due to your...especially if you compromise them hey. They feel hurt, they do need to do business with you but they need to write off a bit so there’s those personal feelings that gets in the way and then they charge you a premium and you don’t have a choice because they are the supplier in the region so you rely on them.” (BRP05)</p> <p>“Your creditors will seek to increase your input costs to recover their position. So, you will find that price negotiations with suppliers, is very difficult.” (BRP08)</p>
	<p>Challenge: Lost credit</p>	<p>“They are not going to be as inclined to supply to you on credit. So, you probably going to have to revert to a COD type arrangement with your supply creditors which has a massive impact on your cash flow so you going to have to find money, cash somewhere else to fund your operations.” (BRP11)</p> <p>“They just don’t want any more risk. They would like to carry on supplying you because the more they supply you the more profitable they are but they going to make sure...most of the time they make you pay them in advance. They make you transfer the money into your bank account the day before they deliver. So that works for them. So, most of the time there is no other real demands from creditors, just cash up front.” (BRP12)</p>
	<p>Challenge: Demand payment</p>	<p>“When you file for business rescue all your creditors rock up and say I’m not supplying you a single widget, okay, either until you pay me my arrears or unless you pay me up front.” (BRP03)</p> <p>“So, what you face on day one of your business rescue is all these people dropping these acknowledgements of debt there and they say it was signed before business rescue and you’ve got to pay and all those kinds of things. Now in those instances you don’t pay the people because there’s no distinction. If they want to enforce that acknowledgement of debt, that’s legal action that they want to enforce and there’s a moratorium. So, they are getting seriously annoyed with the business and the people and all those.” (BRP09)</p>
	<p>Challenge: Suppliers do not deliver</p>	<p>“...then what also happens is they say “we will supply you on cash” then you pay the cash and then they don’t deliver. They just say they will put it off your old account. That does happen, very unprofessional but it does happen.” (BRP13)</p>
	<p>Biggest challenge in business rescue</p>	<p>“You can’t get stock, you can’t trade and then you doomed for failure. So, it’s really as simple as that. If your creditors don’t support you in business rescue, I question if your business rescue can actually be successful.” (BRP04)</p> <p>“The main challenge that we have at the moment with rescue is supplier based” (BRP10)</p>
	<p>Consequence: Cash flow problems</p>	<p>“The moment you go into business rescue there’s this mass hysteria around everybody that you are dealing with um employees, unions, suppliers, customers, so all of those kind of create issues that you</p>

Sub-themes	Code	Raw data extracts
		<p>wouldn't have otherwise. So, the first one, which is the obvious one, is that your suppliers dry up your credit. So instead of being able to buy something on 30 or 60 days credit, you now have to pay cash. So now you've got a cash flow impact on your business on day one, which is often very, very difficult for companies to overcome. That's probably one of the biggest difficulties but there's a cost to that." (BRP06)</p> <p>"I mean if you aren't able to get the supply then your machines aren't working, your factory is not working, you not putting out, you not generating so it has a whole knock-on effect on the entire chain of...let's assume we in a manufacturing business, so cash flow is everything." (BRP11)</p>
	<p>Consequence: Decreased productivity (resulting in decreased sales)</p>	<p>"You know um so when a company is distressed they may, for example if it's a manufacturing business, they may manufacture not in the most effective manner but in the most cash able manner. So, they may only be able to buy raw materials when they have cash. Because maybe the loss of goodwill with suppliers has put them on a cash basis or they may be in arrears so until they settle the arrears suppliers won't supply them anymore. So, they don't manufacture in order to achieve manufacturing efficiencies, they manufacture on the basis of which raw materials they have cash to buy." (BRP01)</p> <p>"Well if you don't get goods, your productivity will deteriorate, and your sales will deteriorate. So, it's a knock-on effect." (BRP04)</p>
	<p>Consequence: BRP time</p>	<p>"So, there is a key work stream of activity that is not even considered in the Act, which says we have got to get these guys comfortable, we've got to get them back on track, we've got to get this company operating. It creates more work, more cost." (BRP03)</p> <p>"...but they don't understand rescue, they don't know how to engage with rescue, they don't understand how to get involved with it and the time lag and the time delay that comes from having to deal with the suppliers to negotiate how to get them to agree to supply is probably the biggest indirect effect that rescue has. Because it interrupts your supply chain and it will interrupt it for sometimes a few days, sometimes a few weeks and that can be the death. But it's that supplier interaction that is the biggest problem and I think that's getting better. The other thing is complete lack of understanding of how business rescue works, on the supplier's side, the landlord's side, you know the guys don't get it. Landlords are notorious for this, they'll send letters trying to cancel a lease which they don't actually have the right to do. So, then you spend a lot of time distracted from the task at hand of rescuing the business." (BRP10)</p>
<p>Factors influencing supplier goodwill</p>	<p>Ability to pay cash</p>	<p>"Supplier goodwill goes as far as the money in the bank, "I'll gladly continue rendering services or supplying products but first the money in the account then we manufacture or supply" which places a tremendous amount of strain on the cash of the already strained company, but then they happy if you can do that." (BRP05)</p> <p>"...typically, what you have to do is you have to start on a COD and then you can stretch it 14 days and then you can stretch it to 30 days and you can get back into a normal cycle, once you've gained their trust and they understand what's happening." (BRP10)</p>

Sub-themes	Code	Raw data extracts
	BRP reputation	<p>“The social capital of the practitioner. In other words, if the practitioner has a good reputation it may help remedy some of that loss of goodwill.” (BRP01)</p> <p>“Practitioner reputation with your suppliers, your creditors, your banks and all of those...if it’s the wrong practitioner, they will never vote for the plan. They will just be obstructive from day one and they will do their best to get that practitioner removed. If it’s the right practitioner, they willing to work with you. That gets back to how you deal with, for example: what type of fees do you try to sneak into your agreements, how you deal with your creditors, how do you maintain those relationships, are you transparent, are you open, are you honest. So, all of that comes back to the practitioner.” (BRP05)</p>
	BRP skills	<p>“So, with your supplier, it depends on how you deal with your suppliers. Your supplier goodwill depends on your practitioner’s ability and the company’s ability to maintain those relationships. Quite often when you step in, the relationship is already strained because there’s been promises made of payment that never followed through. So, the suppliers are really annoyed, and it makes it difficult to win them back. It’s possible but it’s difficult to win them back.” (BRP05)</p> <p>“That’s one of the most important roles that you play as a practitioner, is that during the first 10 days you meet with every critical supplier that you possibly can and make sure that you first of all convince them as you have convinced yourself that a rescue is going to happen. And that if they work with you, rather than against you, they will get the best out of the deal.” (BRP06)</p> <p>“...now once again the practitioner and how he conveys the message and all those kinds of things, if you do it properly and you disclose enough information for them to understand the position, they actually quite happy to support the business rescue process.” (BRP09)</p>
	Extent of compromise	<p>“So, you’ve got a supplier that’s sitting in fear of the unknown on the extent of the write-off. That has not been helped by certain of our colleagues in the industry that have been submitting plans with proposals of suppliers getting anything between 4 and 10 cents in the rand.” (BRP04)</p> <p>“If the plan is to pay them back all their money, then they are more lenient towards helping you out and to keep on supplying you, even at the existing terms...But if the plan has any sort of compromise, you can forget about them supplying you. They will go over to a cash basis. So, if you don’t pay cash, they are not going to help you.” (BRP13)</p>
	Management behavior and reputation	<p>“If on the other hand, you have been a less than honest business man, you know what I mean you’ve ridden everybody hard, you’ve demanded discounts, you’ve paid poorly, you know if you just all in it for yourself and not a genuine partner with your suppliers and your customers, then it probably confirms your reputation rather than damages your reputation if that makes sense.” (BRP10)</p> <p>“You know often you find that by the time it goes into business rescue the supplier hasn’t been paid for three months and the owner keeps promising that he will pay him tomorrow or next week and he never pays him and the next thing he is in business rescue and the supplier just received all these promises and he is [angry]. So, we often have to</p>



Sub-themes	Code	Raw data extracts
		deal with that. So, the goodwill, by the time it's gone into business rescue, has often deteriorated substantially." (BRP12)

**Table 26: The link between the codes, sub-themes and the indirect cost source, a decrease in employee morale and productivity**

Sub-themes	Codes	Raw data extracts
Challenges faced with employees	General decrease in morale	"Employee morale on average, in general, I think goes into decline" (BRP01) "...it really destabilises the staff and you've got to kind of work hard with them" (BRP05)
	Morale was low before business rescue	"But if the company has gone through strain for a while and now someone steps in and now all of a sudden creditors don't scream and shout at me every single day anymore. So, then they see it to be positive as well. They can now relax, if there's a difficult creditor, someone that can deal with the creditor. So now they have some time to reorganise themselves as well." (BRP05) "Normally when it goes into business rescue is when morale is at its lowest. So as the business rescue practitioner, you've got the opportunity to take the company from rock bottom, as far as morale goes, and actually increase it until the company has been fixed." (BRP12)
	Stress due to uncertainty	"...the stress factor of not knowing whether you will have a job tomorrow I think there's a huge cost to that." (BRP07) "Staffs immediate concern is are they going to get paid this month, if they going to get retrenched is their retrenchment going to get paid and when. So, they become very insular and the next thing they do is say where can I find other work that's more secure." (BRP08)
	Reason: business rescue reputation	"...and because of your current low success rate of business rescue, employees deem the business rescue to be the slow death of the company." (BRP04)
	Consequence: BRP time	"That fear that they going to lose their job, that fear that they won't get paid all results in anger and resentment and lack of trust. The effect of that is, as a practitioner and management...you have to spend a lot of time engaging with them and allowing them to ventilate and express their feelings and you have to try providing them with some certainty. So, the most significant thing is that it takes a lot of time and energy from the practitioner to engage. So, it's a delicate and sensitive matter. It requires time and thought." (BRP01)
	Decrease in productivity	"...employees will try and maximise their sick leave if a company goes into business rescue. You have got casual labour and they will just not [show] up for work, they will go for interviews at other companies and employees will probably do the minimum that's where it's at. If you don't see a future for yourself why should I put myself out there. So that's what happens." (BRP04) "...some [employees] have the mentality "okay we in rescue, no it's going difficult so I will do the bare minimum because I'm going to lose my job in any case so I will just hang around here, make sure I sign in the clock in card and I'll just sit here till five and then I'll go". So that's

Sub-themes	Codes	Raw data extracts
		very difficult to then tell them “listen, you need to work now or else this thing is not going to work”. They don’t necessarily see it that way, so they do bare minimum.” (BRP13)
	Safety issues	“When your workforce’s morale drops, productivity drops, and if productivity drops, you end up paying for it in many, many ways. You can pay for it in terms of safety going for a ball of chalk and people can die. Like in the mining industry, if the morale is low and they drop the ball on safety. Before you know it, you can have a fatality. Somebody is negligent, somebody is tired, somebody who is worried, didn’t eat breakfast and went to work “ag my company’s in business rescue, I’m going to lose my job, I can’t pay my debt”. Totally preoccupied, doesn’t watch and boom gone.” (BRP03)
	Theft	“The one experience we had in Company A, employees started stealing wherever they could, because they say the company is not going to survive and we are going to be out of a job. So we caught, wow, about eight employees stealing. So, the moment you go into business rescue you need to up your security because your employees will steal because they see this as a sinking ship. I’ve seen it in many instances. It’s kind of a trend.” (BRP04)
Factors influencing employee morale	Level of education and position	“So, it all depends on the level of education and the understanding of business rescue by the employees.” (BRP02)
	Blue-collar	“...you know the guys that work in the factory, they don’t necessarily understand it, business rescue. As long as they get paid its fine, you carry on doing what you do, and I’ll do what I do as long as you pay me. If you don’t pay employees a salary, then you have a major crisis...” (BRP05) “It comes but when they get their salary at the end of the month, it goes away. So, there’s an initial concern. And if you say to employees, don’t worry you going to get paid and if you actually pay employees, it goes away.” (BRP10)
	White-collar	“White-collar workers, tend to become a bit more skittish and unsure of their position. So, people will look outside the company for roles. And they get quite worried and concerned about “is the company going to survive? Will I have a job?”.” (BRP06) “Your white-collar workers, I think it definitely affects their morale because they will immediately start looking for other jobs and so on. Sort of, you know, key functions and controls will fall by the way side, sales people won’t be motivated anymore, your finance people will be looking for other jobs, and your operations people will be looking for other jobs.” (BRP12)
	Relationship with unions	“Well if they are unionised then that can be a problem because there is miss-information. A lot of misinformation going through. So, you have got to handle it with gloves” (BRP02) “You know I generally have meetings with the unions and I’ll develop a good relationship with them and interesting enough for me, the unions tend to like me because I’ve come and replaced management and that’s where the antagonism sits. So, my experience is not that it’s a major issue. I think if you were looking for major retrenchments you going to have some issues but generally you manage that quite well. I have closed down a whole raft of businesses around a business I

Sub-themes	Codes	Raw data extracts
		rescued in City A and you know we managed it, it worked, and it was fine, and everyone was okay, they understood the reasons why.” (BRP06)
	BRP skills and communication	<p>“Do simple small things; you need to communicate with them, you need to chat with them, you need to show them progress and you know once in a while, do a braai even if the company is under strain, at least continue business as is. You know show the guys we here to make it work. But communication, I presume, is the most important one. Where we are; where we are going; what’s the idea.” (BRP05)</p> <p>“So, it [employee morale] depends on how well you communicate with large numbers of staff. So, you have to have active communication about what the process is, what’s happening now, what’s happening next, where are we with salaries and wages, when are they going to get paid. It’s about your communication skills.” (BRP08)</p>

**Table 27: The link between the codes, sub-themes and the indirect cost source, key employee and management turnover**

Sub-themes	Codes	Raw data extracts
Challenges faced with employee turnover	Consequence: Lose key employees	<p>“Highly mobile employees, that turnover is increased. So mobile employees, employees who have options get out. Employees who have options without high switching costs, leave. Employees with options but with high switching costs like some sort of golden handcuff...may be less inclined to go. Employees with limited options hang around as long as possible. They can often become a burden. So, you lose the best people and you have to deal with the less capable people.” (BRP01)</p> <p>“...you’ve got staff that are feeling nervous and jittery and your best staff are the most likely to leave, which is never a great thing.” (BRP06)</p>
	Increased management turnover	<p>“Many of the times I get rid of them. I’ve only had two rescues, no three rescues in the last two years where the management has stayed.” (BRP02)</p> <p>“Here’s the truth, I have never gone into a rescue with the intention of changing management, I have never come out of a rescue not having changed management. It’s just, you need fresh people, it’s required.” (BRP06)</p>
	Consequence: Void makes BR challenging	<p>“Well it leaves a void which now has to be filled by people of lesser competence in that specific discipline. So, it just makes it more challenging again.” (BRP04)</p> <p>“...that’s institutional knowledge, I mean how am I going to know what the issues were on that contract...I can just walk into his office and say, “wats die storie hierso” and he will say to you this, this and this. Now if I have to find that out and he is not there anymore, I’m up the creek without a paddle. So, losing good people is a big threat, a big threat.” (BRP11)</p> <p>“...it is that institutional knowledge and under circumstances where you are distressed you have to make quick calls and quick calls can only be made if you have good information, good information only comes from quality people.” (BRP11)</p>

Sub-themes	Codes	Raw data extracts
	<p>Consequence: Difficult to replace key employees</p>	<p>“The cost of losing key individuals within a company and having to replace them are massive, huge. If you have somebody critical that says listen I’m going to Company B, I’m out of here guys and you now have to replace that person. How do you measure that, it’s massive. You have to get a consultant because who is going to come and work for a company that’s in business rescue, so you have to get a consultant and pay double or triple than what you would have paid as a salary.” (BRP03)</p> <p>“...it’s always difficult. You know skills are short in this country, first thing. And the second thing is you putting them into a slightly risky situation because you want to put them in to put you out of business rescue but you not out of business rescue. So, it is quite hard to replace them.” (BRP06)</p> <p>“...never mind the fact that the new guy might take three months to learn how to do the job or get the background or whatever, the company is in rescue, what job security does he have?...So to replace them in a business that’s not flourishing yet, even though it is still in rescue, I think is very difficult.” (BRP13)</p>
	<p>No consequence: Do not need to retrench</p>	<p>“Now sometimes it’s also a bonus because you lose people you really wanted to fire but you haven’t gotten around to it yet and you lose them.” (BRP05)</p> <p>“Sometimes it’s a good thing for the business because now you don’t have to retrench people...” (BRP07)</p>
	<p>No consequence: Plan and fill void</p>	<p>“...you know we are having to generalise but generally speaking the answer is no because I’ll always fill the void.” (BRP06)</p> <p>“...we have been around the block a lot so if there’s a gap coming up, then we’ll either find someone to step in and plug it on a short-term basis or we’ll put controls in place to deal with it. You know so...and it depends a lot on the business and what’s going on, but you know, it’s normally not too much of a problem.” (BRP10)</p>
	<p>Benefit: Improves relationships</p>	<p>“Normally management have stuffed up, and once they see that there is somebody holding management accountable you can use that to your favour. So sometimes morale gets better because they see their bosses are getting into trouble. But it all depends on how you approach it.” (BRP02)</p> <p>“But usually when you get rid of the wrong person, your relationship with the rest of the employees and the suppliers immediately better, it improves. Because quite often that guy or that person is recognised as one of the major issues within the company and when you remove that person, your employees immediately feel “hell, something is being done, we are going in the right direction” and it’s the same with your suppliers.” (BRP05)</p>
<p>Factors influencing employee turnover</p>	<p>Competitor reactions</p>	<p>“Particularly your sales people. So, your competitors will steal your good sales people first. Your competitors will steal your good staff first. So, they start...there’s a strong predation on your sales force.” (BRP08)</p> <p>“...but what I have found is that your human capital, let’s call it your really good people, are either headhunted or find alternative employment.” (BRP11)</p>

Sub-themes	Codes	Raw data extracts
	BRP skills and communication	<p>“Ja so the cost that you then end up with is that you need to retain them. So, you bring them on board as part of the business rescue effort and you incentivise them to stay.” (BRP03)</p> <p>“What we sometimes do in our matters, as part of our pre-assessment or early assessment, is we identify people who are critical for a successful rescue and you try and incentivise them to stay.” (BRP11)</p> <p>“...it depends on how you engage with those staff. So you want to find out who the key staff members are and who the good ones are that you need to keep and you need to work with them...if you, as practitioner, are continuously engaging with those staff members, then they are more likely to stay and they are less likely to get demotivated. The quickest thing that will make them leave is if they are sitting there and they are thinking “I’m not really doing anything, and nobody really cares what I’m doing, my job is probably not even that important and I’ll probably be out of a job in three months’ time, so let’s start looking for a new job”.” (BRP12)</p>
	Duration of proceedings	<p>“Keep them as short as you can. Try and contain the damage. As long as this goes on, the more that happens. So, people lose confidence in rescues at about 6 months.” (BRP08)</p>
	Management behaviour and behaviour: obstacle to business rescue	<p>“So, they [management] are resistant to change. So, when someone is resistant to change, sometimes you have to remove them, it’s because they block change.” (BRP06)</p> <p>“You’ve got to ask yourself, if this board or management team managed to drive this bus up a dark alley they couldn’t get out of, are they the right people to reverse it out? I’m not sure they are. It might be, in fact it always is, that there are elements within the management team that are solid, and you want to keep them. You want continuity and you want some institutional experience to stay with you but the people who stand in your way, you have to remove them.” (BRP06)</p> <p>“...well you would remove them in circumstances where their continued presence is so negative it actually affects the process.” (BRP11)</p>
	Management behaviour and reputation: reason for distress	<p>“90 percent of the time the company is in trouble because of its people. I very rarely come across a company that has gone into business rescue for reasons other than its people.” (BRP03)</p> <p>“However, where it is a business being badly run in a market environment that should be conducive to the business performing well, there I would say there should be a high turnover of management because you cannot take the business out of business rescue with exactly the same team as where it went into business rescue if its endemic to the management of the company.” (BRP04)</p>
	Management behaviour and reputation: fraud	<p>“In fact, in a recent business rescue, we actually fired the CEO and his right-hand woman, and he is a 75 percent shareholder. We actually legally fired him, we terminated his employment...he was also an obstacle to the business rescue because he was perusing his own agendas and he was not doing what was necessary to support the objectives of this rescue. And he stole some money and we fired him and laid a criminal charge and he’s a 75 percent shareholder.” (BRP01)</p>

**Table 28: The link between the codes, sub-themes and the indirect cost source, the inability to raise finance**

Sub-themes	Codes	Raw data extracts
Challenges in raising PCF	Important for survival	<p>“It’s one of the biggest causes of failure [inability to raise PCF]. There are three things which causes, I would say, 90 per cent of all failures in business rescue...And the third cause is the availability of PCF and PCF is really hard to come by.” (BRP06)</p> <p>“That’s basically impossible [raising PCF]. There are three components, in our minds, that help or that you need to have a successful business rescue...And the third component is post commencement finance. So, if one of those three is missing it’s not going to be a rescue in our opinion.” (BRP13)</p>
	Do not start without PCF	<p>“...you may advise the company not to go into business rescue. Because if you can’t raise any further funds and you know that going into business rescue the bank is going to freeze your over draft and your customers are going to be difficult on you...” (BRP07)</p>
	Difficult to raise	<p>“That’s challenge number one and number two and number three. You can take it as far as you want, that’s the challenge, is to raise post commencement.” (BRP09)</p> <p>“...credit terms and post commencement finance are the two most difficult things to achieve in rescue.” (BRP10)</p>
	Expensive (comes at a cost)	<p>“There’s obviously guys that specialise in post commencement financing, but it’s never cheap. It’s always fairly expensive in terms of fees they charge and in terms of interest. Interest is not usually the end of the world; you can expect it to be higher than normal. But the fees they charge, you know a type of contingency fee they charge or a management fee they charge for the money is quite a bit expensive. So those costs, funding costs, is a problem and that adds up to quite a bit.” (BRP05)</p> <p>“There’s a couple of private companies that do it, fairly new. I mean there’s a couple of business rescue guys who have money who do provide PCF. For anyone whose got money it’s a nice business provided they know what they are doing, provided they are making sure there’s adequate security in place and everything like that because they are earning nice interest rates, you know they are lending at about 20 percent.” (BRP12)</p>
Factors influencing the ability to raise PCF	No PCF lenders in South Africa	<p>“There is no post-commencement supply from independent externals. It doesn’t exist in South Africa. Why? Because it’s uncertain and it’s not like in chapter 11 in the states. In the states there’s many mechanisms, there’s even a mechanism where post commencement finance can, by the stamp of a judge, go and sit ahead of secured creditors.” (BRP03)</p> <p>“So, Bank B have said, we will assess you on the normal lending criteria that we apply to all our customers. And then you kind of go “well we never going to pass that criteria”. Bank A just point-blank refuses to support any business rescue, there is no business rescue that Bank A has supported that I’ve been involved in. And to the extent that a client comes to me and Bank A is their main banker I will not accept their rescue. Bank C and Bank D have been better, but only in the senior...in the big lending space and in the small lending space I’m not that excited.” (BRP10)</p>

Sub-themes	Codes	Raw data extracts
	Availability of free assets	<p>“If there are no unencumbered assets, then forget it, no finance will be raised. If there are unencumbered assets, your first checkbox is ticked.” (BRP05)</p> <p>“It must be secure, most of the companies have already given away their security to get to the point where they are.” (BRP09)</p>
	Security is only the first step	<p>“So, its assets, it’s who the practitioner is, it’s the industry and it’s the management of the company. They look at the before they sign the documents. So, it’s not as simple as “yes we have assets”, that just opens the door for further discussion.” (BRP05)</p>
	Uncertainty of PCF ranking	<p>“There’s just not enough certainty around the ranking and we all know what it’s intended to mean but it doesn’t say that, so your sources of PCF funding are limited...” (BRP11)</p>
	Assets sold or encumbered before business rescue	<p><b>Discussed below (links with theme below)</b></p>
	Management behavior and reputation	<p>“Well in the first instance the company already lost all credibility with all the parties that it needs to raise finance from. Because its defaulted and it hasn’t honoured its commitments. So that’s your first problem. Your second problem in raising PCF is because of these defaults and not honouring commitments, your suppliers and financiers have lost confidence in management and they say well management caused this to get to where we are now. So, it’s that lack of confidence in management.” (BRP04)</p>
	BRP skills and reputation	<p>“You will find that certain PCF providers will not work with certain practitioners because they’ve been burnt by some of those practitioners or they have seen that those practitioners are negligent in their duties or they are not ethical or professional in what they do. They don’t trust the practitioner so therefore they will never provide finance if that practitioner is the practitioner on the specific project.” (BRP05)</p> <p>“Oh yes, practitioner reputation is the most important thing. They won’t even look at the assets if the wrong practitioner is in place. They will not provide finance to the wrong practitioner or to someone they had a negative experience with before.” (BRP05)</p>

**Table 29: The link between the codes, sub-themes and the indirect cost source, inefficient asset sales**

Sub-themes	Codes	Raw data extracts
Asset sales as a method to raise finance	Assets sold to raise cash	<p>“So, to generate cash, it does happen but if it’s part of a plan that underpins the creditor or gets underpinned by the creditors by an adoption then sure.” (BRP03)</p> <p>“If you not going to get other forms of PCF you’ve got to generate the cash flow internally. So, it’s definitely driven by desperation and is definitely driven by the need for cash.” (BRP04)</p> <p>“Because of the lack of availability, the general lack of availability of PCF. You must always remember, you need to fund the business during business rescue. You’ve got to keep it going, you’ve got to keep the wheels turning.” (BRP06)</p>

Sub-themes	Codes	Raw data extracts
	Non-core assets and subsidiaries	<p>“One of the first things I’ll do is look for non-core assets. And I’ll go look at non-core assets and see if there is an opportunity to release cash to fund the business by getting rid of non-core assets.” (BRP06)</p> <p>“If a product line is not performing you get rid of it. The same with subsidiaries, if the subsidiary does not contribute you get rid of it. You not going to carry anything in business rescue that’s unnecessary.” (BRP09)</p> <p>“So, you cut on efficiencies, you retrench staff, you retrench costs and all those kinds of things, unnecessary vehicles whatever, you sell all excess assets, you just get rid of it to survive with what you’ve got. That’s why I say you shrink it into greatness.” (BRP09)</p>
	Sold or encumbered before business rescue	<p>“In practice there are more often than not very limited unencumbered assets available to raise cash.” (BRP01)</p> <p>“...we’ve had instances where you could save the company if we were involved with the company a year earlier because they’ve sold off unencumbered assets to sort out their problems...but now 18 months later they’re in the same predicament but now they don’t have any assets to bargain with and to raise funds and to raise capital. And I’ve seen it so many times, that guys sell the assets and then a few months later they in the same position because they are just useless in managing the company and there’s nothing to be done, you can’t save them.” (BRP05)</p> <p>“Usually when you get there all unencumbered assets are gone, they are already sold. So that puts the emphasis on filing for business rescue in good time. If you going to start selling off assets, it’s too late to file for business rescue basically.” (BRP09)</p>
	Reason: save core business	<p>“If you not going to get other forms of PCF you’ve got to generate the cash flow internally. And the logical way to do that is to sell any assets that are not sweating and to dispose of a subsidiary that you can get a substantial amount for in order to save the core business.” (BRP04)</p> <p>“We had to sell an operational division for a massive discount. A division that was lucrative and could have been so much more in the future, had to be sold so that we can generate cash to support the main operations.” (BRP05)</p> <p>“...you must remember what I’m trying to do is avoid liquidation. So, if it’s that I end up with half the business that I had before, but I put everybody in a better position than they would have been under liquidation, then I’m surely in a better position. So, if I keep two divisions and they go into liquidation or if I had one and I’m solvent and my creditors get paid, surely there’s no debate.” (BRP06)</p>
Factors influencing proceeds	Proceeds below market value	<p>“Other indirect costs would be for a company to sell an asset which they really don’t want to sell but they forced to sell. So, you sell it at a suboptimal price. You don’t really want to sell it at this price, but you don’t really have a choice. And sometimes it’s a going concern that you sell, it’s a division that you sell and always at a discounted rate.” (BRP05)</p> <p>“When you are selling something out of a distressed environment, like you are selling something out of business rescue or especially in liquidation, you will always get less for it than you would normally get.” (BRP12)</p>



Sub-themes	Codes	Raw data extracts
	Proceeds are fair	<p>“You sell some assets in a bit of a hurry, but you are getting the best price you can under those circumstances. If you go to one person and say “what will you pay me” then you’re a bit of a fool. What you’ve got to do is make sure that when you sell it you use professionals, or you use the appropriate techniques to get as many buyers as possible, they all know they are bidding against each other and you know you getting the best price.” (BRP06)</p> <p>“So anywhere between market value and forced sale value is usually a good return under rescue circumstances. But there’s no reason you should be selling them for too much under what they are actually worth.” (BRP13)</p>
	Buyers take advantage	<p>“But if you in business rescue and you trying to sell an asset people are looking for bargains. Unless you have more than one interested party, you probably going to have to be willing to part with it at a little bit of a discount.” (BRP11)</p> <p>“But if it’s a property like a farm for example and they see that the company that’s selling it is in business rescue, then they will come and offer you like a quarter of the value of the farm and you’ve kind of got to wait till you get a decent price, you can’t be too desperate.” (BRP12)</p>
	Urgency of sale	<p>“If you sell something because you have to sell it urgently you going to have to sell it at a discount. If you able to sell it in a willing buyer, willing seller type scenario overtime, you can probably negotiate a little bit more.” (BRP11)</p> <p>“Inevitably the more urgently you need to sell it, the lower the price that you’ll get for it” (BRP12)</p>
	Type of asset (degree of specialisation)	<p>“Look I mean if it’s a car then not really because a car, you just drive it to the dealership and it doesn’t matter if you in business rescue or not, they will buy it from you at a fixed price.” (BRP12)</p> <p>“So, it all depends on how you market it and who you entrust to market them and get them sold. So, we had a small rescue the other day and we sold the vehicles at 15 percent more than their market value. So, it depends, and it depends on the approach that you do. So, as I said if you dump it in the market your likelihood of getting a proper return is less and it also depends on the speciality, how specialised the assets are. Very specialised, you going to struggle and if you want the cash quickly your price is going to go down otherwise you can wait until someone comes around and buys it. So, it all depends on the nature of the assets and the way that you realise them but there’s no default reason that you should get less than what they are worth.” (BRP13)</p>