Factors influencing the provision of turnaround finance to financially distressed companies in SA

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ABSTRACT

The major theme of the research relates to the factors which influence the provision of turnaround finance to financially distressed companies in South Africa. The purpose of this study is to identify and investigate the factors influencing the provision of turnaround finance from a macro-environmental, industry-wide, and company-specific perspective. The key findings in relation to the influencing factors were distilled into broad recommendations for consideration by the shareholders and managers of financially distressed companies when attempting to secure turnaround finance.

The study employed the use of semi-structured, elite interviews with senior executives within the professional fields of law, corporate finance, specialist finance, and turnaround management in an effort to incorporate a wider context in relation to the research problem and to overcome the limited data phenomenon relating to researching turnaround situations.

The findings of the study are that the provision of turnaround finance to distressed companies represents a means to restore corporate value in economically viable distressed companies and the factors which influence the provision thereof exhibit interrelationship which shareholders and managers of distressed companies need to understand and appreciate in order to successfully secure turnaround finance.

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DECLARATION

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other University. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

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Nchaupe Khaole **Date**

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CHAPTER 1

1. INTRODUCTION TO RESEARCH PROBLEM

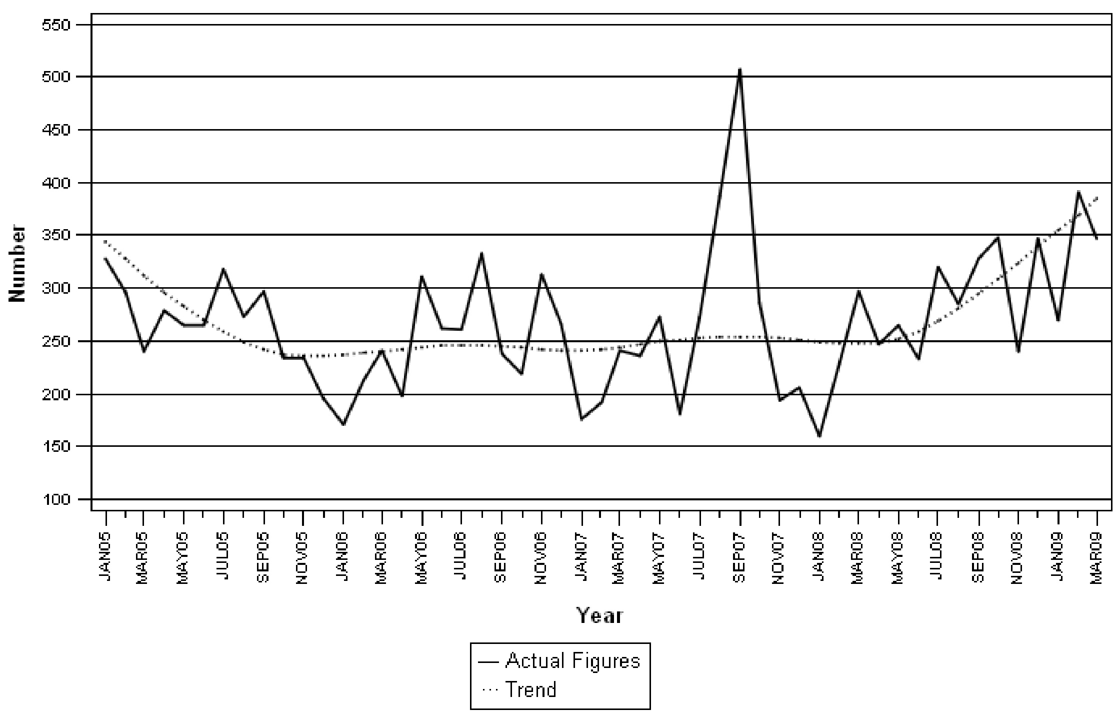
1.1 Introduction

The aim of this study is to identify and investigate the factors influencing the provision of turnaround finance, in the form of debt or equity capital, to financially distressed companies in South Africa. The study seeks to consider the influencing factors on three levels, namely: macro-environmental factors, industry-level factors, and company-level factors. The study seeks to distil the key findings in relation to the influencing factors into broad recommendations to be considered by the shareholders and managers of financially distressed companies in South Africa when attempting to secure turnaround/emergency funding for their operations during turnaround (business rescue) exercises.

1.2 Research motivation

The total number of liquidations recorded for the first quarter of 2009 increased by 46.7% (from 687 to 1008) compared with the first quarter of 2008 (Statistics South Africa, 2009). According to Statistics South Africa (2009) the increase in the total number of liquidations for the first quarter of 2009 was as a result of a 52.5% increase in voluntary liquidations (from 602 to 918) and a 5.9% increase in compulsory liquidations (from 85 to 90). The considerable increase in voluntary liquidations compared to compulsory liquidations suggests increasing financial distress amongst South African companies as a result of moderating economic activity and relatively high interest rates. The trend as depicted in Figure 1 below suggests that company liquidations are entering an upward cycle. An upward cycle with respect to company liquidations is associated with increased turnaround activity in an attempt to salvage corporate value. The need for turnaround finance by financially distressed companies should increase as the liquidation industry enters this upward cycle.

Figure 1: Total number of liquidations
Source: Statistics SA

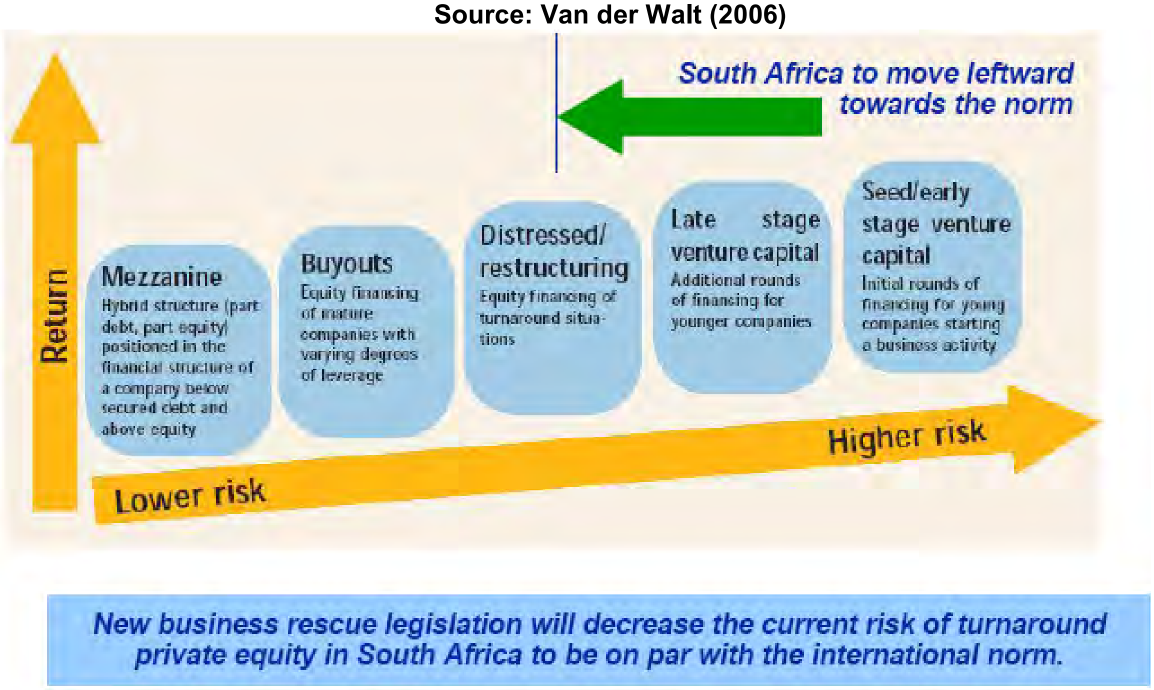


Currently in South Africa, a company experiencing financial distress has limited options at its disposal; it can commence formal business rescue proceedings (as prescribed within Chapter 6 of the Companies Act No. 71, 2008), embark on an informal (i.e. out-of-court resolution) creditor workout exercise, or alternatively apply for voluntary liquidation of its operations. To the extent that the management and/or shareholders of a company believe that its operations remain economically viable despite the onset of financial distress, a business rescue plan or turnaround plan will typically be formulated, often with the assistance of a turnaround practitioner, and presented to a court for approval (in the case of formal business rescue proceedings) or to the company's secured and unsecured creditors for their approval (in the case of an informal workout). A key component of the turnaround plan involves securing turnaround finance to meet short-term trade obligations, cover turnaround costs, and to restore the company's balance sheet to solvency (Corporate Renewal Solutions, 2007).

Securing turnaround finance presents a challenge for financially distressed companies as their borrowing capacity is often limited by a lack of unencumbered assets to offer as collateral as well as existing debt obligations (Corporate Renewal Solutions, 2007). In an attempt to encourage turnaround financing, section 138 of Chapter 6 of the Companies Act No. 71, 2008 ("New Companies Act") makes provision for *Post-commencement finance* which ranks in preference to existing unsecured claims against the debtor company. Van der Walt (2006) contends that this provision as well as other debtor-friendly provisions within the

New Companies Act should stimulate turnaround private equity in South Africa and result in the South African private equity market conforming to international norms in terms of risk/return profiles (see figure 2 below).

Figure 2: Private equity risk/return profiles
Source: Van der Walt (2006)



At present, there are no specialist turnaround private equity firms in South Africa and while some private equity firms do invest in turnarounds, they tend to invest in underperforming companies rather than in distressed companies (Van der Walt, 2006). Therefore, financially distressed companies in South Africa have a twin difficulty in attracting both turnaround finance in the form of loan capital and private equity capital.

Internationally (particularly in the US), the distressed investment and turnaround financing (through debtor-in-possession financing, “DIP” financing) market is a lot more developed and sophisticated. Alternative investment managers such as private equity funds and hedge funds are increasingly participating in distressed investment activity. According to Brecher, Breslow, Harris, Horgan, & Martini (2007), these investors can be divided into two categories: return investors and control investors. Return investors purchase claims against distressed companies with the hope of later selling these claims at a profit or obtaining a recovery under a plan of reorganisation greater than the amount they paid for their claims (Brecher *et al*, 2007, p. 49). Pre-packaged bankruptcy transactions facilitate this form of distressed investment strategy. Control investors, on the other hand, seek to acquire control of a distressed company by acquiring the majority of the (impaired) claims of claimholders of the company at a discount to their face value, providing debtor-in-possession financing to the distressed company to fund its reorganisation plans, and swapping their debt holding for equity in the company as part of the reorganisation plan. Internationally, alternative investment managers have managed to increase their deal flow as well as their return profiles by considering distressed investment activity. The possibility for South African alternative investment managers to achieve same can be enhanced by their involvement in distressed investment activity.

1.3 Research scope

The scope of the intended study is limited to the identification and investigation of factors which influence the provision of turnaround finance from a macro-environmental, industry-wide, and company-specific perspective. The capital providers considered within the context of the study will be limited to commercial banks, development finance institutions, private equity firms, specialist financiers (e.g. mezzanine funds, debtor factoring companies, etc), and turnaround management consultancies. Though turnaround management consultancies are not capital providers in the strictest form of the definition, their experience in utilising internal forms of turnaround finance, for example, working capital improvement, cost reduction, and asset reduction (Corporate Renewal Solutions, 2007) is essential to understanding the factors influencing turnaround finance. The intended study will be limited to the provision of turnaround finance to financially distressed public and private companies in South Africa.

1.4 Research problem

This study will attempt to articulate the factors influencing turnaround fiancé from a macro-environmental, industry-wide, and company-specific perspective. The study seeks to distill the findings into generalised recommendations to be considered by the shareholders and mangers of financially distressed companies in South African when attempting to secure turnaround finance.

1.5 Research objectives

The research objectives of this study are as follows:-

- **Research objective 1**: Determine what the macro-environmental drivers of turnaround finance in South Africa are;
- **Research objective 2**: Examine to what extent the current and proposed legal frameworks as relates to turnarounds facilitate turnaround finance;
- **Research objective 3**: Determine whether industry specific factors are taken into consideration with respect to turnaround finance;
- **Research objective 4**: Examine the risk and return considerations as relates to turnaround finance;
- **Research objective 5**: Identify the alternative forms of turnaround finance available to distressed companies in South Africa.

CHAPTER 2

2. LITERATURE REVIEW

2.1 Macro-drivers of turnaround activity

Macro environmental factors include political, economic, social, technological, environmental, and legal factors, all of which can influence, to varying degrees, the level of turnaround activity in a particular country. The macro environmental factors of interest for the purposes of this review are the economic and legal environment within which turnaround activity takes place.

2.1.1 Economic environment

It stands to reason that macro-economic instability (in the form of slowing economic activity, high real interest rates, and exchange rate volatility) is likely to lead to an increase in incidences of bankruptcies and liquidations within a country. This is evidenced in Koopman and Lucas (2005) who used US data on real GDP, credit spreads and business failure rates from 1933 – 1997 and found evidence of co-cyclicality between defaults, credit spreads, and GDP. The cyclical co-movements between GDP and business failures were strongest (i.e. significant) for business cycle frequencies in excess of eleven years as compared to ‘typical’ business cycle frequencies of six years. The findings of Koopman and Lucas (2005) confirm that a slowdown in economic activity would lead to an increase in business failures and additionally that the lending margin (credit spread) widens in tough economic times and makes it more difficult for companies to raise loan funding, particularly companies in distress.

Distressed companies operating in such an economic environment need to consider, as an option, being bought by their competitors as an alternative to being liquidated, however, mergers and acquisitions activity is pro-cyclical and as such potential suitors are likely to be fewer in such circumstances (Bhattacharjee, Higson, Holly, and Kattuman, 2009). Bhattacharjee *et al* (2009) developed a model based on over 30 years of data for US and UK listed firms and covering several business cycles, to examine these issues. Their findings confirmed the earlier hypothesis; however, they also found that in a country with a strong debtor-friendly bankruptcy code (e.g. Chapter 11 in the US) reorganisation activity was less responsive to macroeconomic instability. That is, a slowdown in economic activity had less of a marked effect on incidences of bankruptcies in the US, which has a debtor-friendly bankruptcy regime, than in the UK, which has a supposedly creditor-friendly bankruptcy regime. This suggests that the country-specific legal framework within which turnarounds are performed plays a greater role in determining turnaround activity than macroeconomic instability.

Altman, Brady, Resti, and Sironi (2005) analysed, both theoretically and empirically, the association between default and recovery rates on corporate bonds over the period 1982 – 2002, and their findings concluded that macroeconomic variables (in particular economic activity as depicted by GDP growth or contraction) did not explain as much of the variation in recovery rates on defaulted bonds (distressed debt) as corporate bond market variables explained. In essence, Altman *et al* (2005) found that the rate of recovery on defaulted corporate bonds was influenced more by bond market dynamics (i.e. the demand and supply of defaulted bonds) than by macroeconomic activity. The findings of Altman et al (2005) introduce additional factors which influence recovery rates in turnarounds in addition to macroeconomic stability.

The implications of both Bhattacharjee *et al* (2009) and Altman *et al* (2005) are that even though economic activity will likely influence the provision of turnaround finance to distressed companies, there exist other factors which influence this activity. The additional factors include the bankruptcy regime within a country and the existence of an active secondary market to trade claims against a distressed company. The literature reviewed in this regard focused primarily on developed economies as the absence of secondary data in developing economies makes the formulation and testing of such constructs difficult.

2.1.2 Legal environment

The legal system within which turnaround activity takes place has a bearing on the success of turnaround efforts and as such influences the likelihood of whether distressed companies can raise turnaround finance. There are differing views, both from practitioners and academics, on what constitutes an optimal bankruptcy regime. Smith and Stromberg (2004) argue that the main reason for corporate bankruptcy laws is to resolve bargaining frictions in financial distress situations. They develop a framework which compares the bankruptcy systems in six different countries: France, Germany, Japan, Sweden, the United Kingdom, and the United States. Their analysis suggests that the features of an efficient bankruptcy regime (i.e. one which maximises ex-post efficiency) can be categorised into two groups, (1) those that ensure the going concern value of the firm during the procedure, and (2) those that maximise the potential for bidders to compete for the reorganisation of the firm (Smith and Stromberg, 2004, p43). Furthermore, Dal Pont and Griggs (1996) argue that successful turnaround efforts are only possible in an environment where the realignment of competing interests between creditors and a debtor company are possible and periods of grace are granted to debtor companies to pursue a turnaround strategy which has been sanctioned by all relevant stakeholders. As opposed to arguing for a debtor-friendly or a creditor-friendly bankruptcy code, both Smith and Stromberg (2004) and Dal Pont and Griggs (1996) emphasise the need to provide an environment whereby competing interests can be aligned through bargaining and creditor value recovery can be maximised through competitive tension between bidders for the distressed debtor company. Therefore, an optimal bankruptcy code needs to encourage and facilitate turnaround funding and turnaround investment.

Berkovitch and Israel (1999) advocate the determination of optimal bankruptcy laws based on the economic system prevalent in a country and the information structures within these countries. They develop a model which tests the kind of bankruptcy regime which works best for a country based on whether the economic system in that country is a market-based system (e.g. the United States), a bank-based system (e.g. Germany), or an underdeveloped system (e.g. developing countries). Their model suggests that the most optimal bankruptcy regime for a bank-based system is one which contains a creditor chapter only, as banks already have information on debtor companies by virtue of having representatives on their boards of directors. The most optimal bankruptcy regime for a developed market-based system is one which includes both a creditor chapter and a debtor chapter as creditors and debtors will have access to information as a result of efficient markets, however, both parties rights still need to be protected in the event of a bankruptcy filing. Lastly, the most optimal bankruptcy regime for an underdeveloped system is one which has both a creditor chapter and a debtor chapter as the information available to creditors is poor and as such information asymmetry between creditors and debtors is considerably high.

Therefore, there is no optimal bankruptcy law for all countries, rather the economic system within that country and the degree to which there is information asymmetry between creditors and managers of debtor companies should determine the bankruptcy code adopted.

2.2 Industry related considerations influencing the provision of turnaround finance

Industry related considerations influencing the provision of turnaround finance relate to industry specific forces which impact on capital providers' ability to provide turnaround finance to distressed companies. Literature pertaining to credit risk and investor risk and return considerations is reviewed to establish these factors.

2.2.1 Credit risk considerations

The regulatory environment within which commercial banks operate influences the kind of credit risk they are willing to assume. Providing turnaround finance to financially distressed companies has to be considered within this context. Commercial banks consider their total portfolio risk as well as decomposed individual risk contributions attributable to a particular transaction or counterparty in their capital allocation decisions (Glasserman, 2005). The effect of these marginal risk contributions could negatively influence the provision of turnaround finance to distressed companies, particularly if there were increased incidences of default within the industry within which a distressed company operates (for example, the textile industry in South Africa).

The above assertion relating to industry-wide distress is supported by Acharya, Bharath, and Srinivasan (2007). Acharya *et al* (2007) found that recoveries were affected by economic activity as well as industry wide distress. Recovery rates were found to be lower during periods of decreased economic activity and industry wide distress since asset values of all industry participants would be negatively affected by the industry wide levels of distress. Therefore, from a credit risk management perspective, commercial banks would be less likely to consider extending turnaround finance to economically viable companies to the extent that there was industry wide distress and equally to the extent that there was a moderation in economic activity.

2.2.2 Default risk monitoring

An additional component with respect to credit risk considerations in relation to the provision of turnaround finance relates to active monitoring of probability of default within credit portfolios. Banks utilise credit scoring models which involve a combination of quantifiable financial indicators (financial ratios and capital market values) and qualitative considerations with respect to the credit process (Altman, 2002). Altman (2002, p. 6) states that banking practitioners have reported that these so-called qualitative elements, that involve judgment on the part of the risk officer, can provide as much as 30 – 50% of the explanatory power of the scoring model. He further advocates the adoption of a “risk culture” within financial institutions which relies on both quantitative and qualitative indicators in the formulation and interpretation of credit scoring models to better predict financial distress during turbulent times.

Carey, Post, and Sharpe (1998) analysed a sample of 14,735 loan agreements involving approximately 5,700 different US business borrowers from the November release of Loan Pricing Corporation's Dealscan database, and found evidence which suggests that specialist finance companies (captive financing subsidiaries of nonfinancial corporations, general consumer and business finance companies, leasing companies, and factors) tend to provide loan finance to companies with riskier profiles as well as for riskier purposes (e.g. restructurings and takeovers). Carey *et al* (1998) find that this is due to the fact that regulation limits banks ability to lend to risky firms and that banks avoid risky firms in order to preserve a reputation for reasonableness in renegotiations with borrowers. The evidence suggests that specialist finance companies are in a better position to provide turnaround finance to distressed companies as their lending activities are subject to fewer constraints. Evans and Koch (2007) introduce the size of the firm as a contributing factor in relation to the source of turnaround finance. Their study found that small, closely held firms in distress were more likely to secure turnaround financing from their suppliers than from banks. The findings of Evans and Koch (2007) are consistent with Carey *et al* (1998) with respect to banks' avoidance of extending terms for risky firms. The regulatory requirements banks need to comply with could be an influencing factor in this regard.

The sample used in the Carey et al (1998) study is somewhat dated and relates to US specific data which may bear no relevance to developing countries, however, the evidence allows for a generalisation with respect to the constraints imposed by regulation on banks, which may hinder their ability to provide turnaround finance. This implies that in order to entice banks to provide turnaround finance to distressed companies, their post-distress credit facility needs to rank ahead of pre-distress liabilities of the distressed debtor company both in terms of payment and security. The downside of this super-priority status is that it provides an incentive for managers to over-invest and take greater risks, as detailed in Skeel (2003).

2.2.3 Risk and return considerations relating to distressed investment

The risk and return benefits of including alternative investments (venture capital, leveraged buyouts, distressed securities, private equity, private debt, hedge funds, and managed futures) in a traditional portfolio comprising stock and bond assets are well documented in a number of studies (Schneeeweis, Karavas, and Georgiev, 2002; Amenc, Martellini, and Vaissie, 2003). Alternative investments form an integral part of investors' diversification strategies. Furthermore, alternative investments can enhance investors' portfolio returns during periods of market volatility. This is illustrated by large institutional investors in the US decreasing their allocation to stocks and opting to rather increase their allocation to distressed investment in 2008 in anticipation of an increase in corporate defaults in 2009 (Weiss, 2008).

Despite the risk and return benefits associated with investing in alternative assets, there are other factors which come into play when investment managers consider whether or not to increase their allocation to alternative investments. Terhaar, Staub, and Singer (2003) state that actual portfolio allocations to alternative investments are a function of the investor's risk tolerance, investment horizon, and liquidity needs. That is, the longer the investor's investment horizon, the greater their allocation to alternative investments can be, although in most countries the allocation to alternative investments as a proportion of total assets under management is regulated. Therefore, the optimal mix of alternative investments (that is, the allocation mix between venture capital, leveraged buyouts, distressed securities, private equity, private debt, hedge funds, and managed futures) within an institutional investor's portfolio will be determined by the risk-adjusted returns each asset class offers and the investor's diversification strategy (Healey and Hardy, 1997).

The factors influencing institutional investors' allocation to distressed securities, in particular, are less defined in the literature. The idiosyncrasies relating to distressed securities as an asset class probably contribute somewhat to this. Firstly, the valuation of distressed firms can be a challenge as traditional valuation methodologies assume the valued firm is a going concern (Damodaran, 2002). Furthermore, the conflicting interests of creditors and managers/shareholders of distressed firms can result in "strategic biases" in financial information provided in bankruptcy filings resulting in valuation errors ranging from less than 20% to greater than 250% (Gilson, Hotchkiss, and Ruback, 2000, p. 70). Secondly, acquisition of distressed firms is a specialised field of corporate finance requiring specialist skills and knowledge for success. Bruton, Oviatt, and White (1994) find that prior acquisition experience is a factor in successful acquisition and integration of distressed firms. Lastly, investment in distressed securities can result in exceptional returns for investors depending on the possession of specialist knowledge with respect to valuation and integration of distressed firms. Russel, Branch, and Torbey (1999) found that post-bankruptcy filing investors achieved an average return of 114.59% as compared to pre-bankruptcy filing shareholders who on average lost 70% of their value during the bankruptcy period. The returns achieved are further influenced by whether the post-bankruptcy investor takes up an active managerial role (i.e. Chairman or CEO) within the distressed firm and whether they acquire a controlling interest in the distressed firm (Hotchkiss and Mooradian, 1997). This potential transfer of wealth experienced in distressed investing represents an incentive for institutional investors to allocate a portion of their funds to distressed securities.

2.3 Company specific considerations influencing the provision of turnaround finance

Factors at a firm-level influence the likelihood of whether the firm concerned can successfully secure turnaround finance or not. Literature relating to firm-level characteristics of successfully turned around firms is reviewed in this section.

2.3.1 Factors influencing successful emergence from bankruptcy reorganisation

Denis and Rodgers (2007) tracked and analysed a sample of 279 firms that filed Chapter 11 from before they filed, through the Chapter 11 process, and for three years following the resolution of their filings. they found that firms spent less time in chapter 11 the smaller they are, the higher the median operating margins in their industries are, and the better their own operating margins are relative to those industry median margins. They also found that firms significantly reduce their assets and liabilities while in chapter 11 and that such reductions increase the likelihood that a firm achieves a positive operating margin and a positive industry-adjusted operating margin for the three years following reorganisation (Denis and Rodgers, 2007, p118). Their findings suggest that making use of internal forms of funding (i.e. cost and asset reduction) while in bankruptcy improves the likelihood of successful emergence from bankruptcy. In most instances this is the only means of turnaround finance available to smaller firms experiencing financial distress. Another key finding of Denis and Rodgers (2007) relates to time spent in Chapter 11 in that firms that emerged too quickly from Chapter 11 were more likely to encounter subsequent financial distress during the three years after emergence from bankruptcy.

Kahl (2002) contends that creditors of financially distressed firms lack the information that is needed to make quick and correct liquidation decisions when considering an appropriate course of action once a debtor company is in distress. Kahl (2002) proposes a dynamic liquidation model which encourages creditors to learn more about a financially distressed company's recovery proceedings and in so doing postpone their liquidation decision until they have better information to base this decision on. The adoption of a dynamic liquidation model could serve to avert hasty liquidation decisions when a reorganisation could save an otherwise economically viable company in distress. The creditor is in no way prejudiced as they remain in a position to institute liquidation throughout the reorganisation process, however, at least they would be making the liquidation decision based on better information. Arguably, this could address concerns which capital providers may have when considering whether to finance a reorganisation plan.

Elayan and Meyer (2001) investigated whether receiving Debtor-in-possession (DIP) financing is related to successful reorganisations and a shortened duration under Chapter 11 bankruptcy proceedings. They found that realised returns to equity increase at the announcement of DIP loan agreements. Furthermore, Elayan and Meyer (2001, p906) found that increased returns to equity were greater when the DIP borrowing was relatively large, is from banks (versus non-banks), is from existing lenders (versus new lenders), and is a first DIP transaction (versus subsequent transaction). Their findings suggest that DIP financing transactions relay positive information about the viability of a distressed company. Their findings also emphasise the positive information effects of securing DIP financing from existing lenders, particularly banks, as they are best suited to assess the viability of a distressed company. Chatterjee, Dhillon, and Ramirez (2004) confirm the positive signalling effects arising from DIP loan announcements and they found no evidence of wealth transfers from junior to senior debt-holders. Chatterjee *et al* (2004) suggest that DIP lenders assume a monitoring role over the progress of the turnaround plan. This is consistent with the findings of Chatterjee, Dhillon, and Ramirez (2007) which addressed the ability of DIP lenders to resolve the information asymmetry problem between managers and creditors. This monitoring role can facilitate the dynamic liquidation model detailed in Kahl (2002).

Therefore, the form of turnaround finance utilised by a distressed company can have a bearing on the amount of time it spends in Chapter 11 and its performance post reorganisation. Additionally, small companies are more likely to use internal forms of funding than DIP or Post-commencement financing during reorganisation exercises.

2.3.2 Factors influencing distressed investment activity

Shareholders have a residual claim (i.e. their claims rank last in the event of a liquidation) on a firm's assets (Indro, Leach, and Lee, 1999) and as such distressed firms find it difficult to attract equity investors during turnaround efforts. DIP loan providers are enticed by the super-priority status their claims enjoy while a debtor company reorganises, while equity investors are less inclined to take up an interest in a distressed company as they risk losing their capital. This is why, as noted by Indro *et al* (1999), the preferred investment for investors in distressed companies are distressed debt issues, which later evolve into equity interests once the firm has reorganised.

The practice of investing in distressed companies is popularly known as "vulture" investing (Gilson, 1995). Vulture investing or distressed investing, as it is also referred to as, increased in earnest in the United States during the 1980s, driven primarily by severe downturns in sectors of the economy such as energy and steel, and the 1978 revision of the bankruptcy code, which encouraged companies to reorganise (Rosenberg, 2000, p. 14). According to Bernstein, Polk, and Wardwell (2007) provisions within the Chapter 11 procedure such as the allowance for DIP loans to have super-priority status and the ability of creditor groups to reach a bargained post-reorganisation allocation of debt and equity between themselves on the basis of seniority of claims, facilitates increased distressed investment activity. This suggests that in the absence of a 'debtor-friendly' bankruptcy code, there won't be much distressed investment activity.

An equally efficient bankruptcy resolution mechanism (auctioning bankrupt firms as going concerns) is investigated by Thorburn (2000). By analysing court-supervised bankruptcy auctions in Sweden from 1 January 1988 through 31 December 1991, Thorburn (2000) found that survival rates (75%) of auctioned distressed firms were similar to the percentage of small firms that survive as a going concern through Chapter 11, direct costs correspond closely to direct costs of large-firm Chapter 11 cases, the speed of resolution (i.e. efficiency) was shorter in auction sales (on average, two months) as compared to Chapter 11 cases (on average two years), and debt recovery rates were similar between the two mechanisms. The findings of the study suggest that auctions are an efficient resolution mechanism for small firms in particular. This provides an equally efficient alternative to bankruptcy resolution through Chapter 11-like mechanisms. The implications of the findings of the study are that distressed investment activity can take place in environments with supposedly 'creditor-friendly' bankruptcy laws.

2.4 Concluding remarks on literature review

The literature review has addressed the factors which impact on turnaround activity/distressed investment activity by considering environmental factors, specifically macroeconomic factors and legal environment factors, industry-specific factors, and firm-level factors. It has also considered alternative sources of financing turnarounds and alternative bankruptcy resolution mechanisms, which are no less efficient than Chapter 11. The majority of the literature reviewed uses data from the US primarily or alternatively from developed economies. There is very little literature on factors influencing turnaround successes or failures in developing economies. Pretorius (2008) states that primary data on turnarounds (particularly in developing economies) is “thin on the ground”, due to the fact that failed firms disappear and the successful turnarounds are attributed to the “leadership ability” of incumbent management teams and/or consultants’ input, who tend to protect their intellectual property and give away little insight into the factors which contributed to successful turnaround of troubled firms. The point of departure of this study is to aggregate the opinions of experts involved in the turnaround management industry in an effort to present the factors which influence the provision of turnaround finance to distressed companies in a developing economy.

The aim of this study is to expand on the current body of knowledge relating to factors which influence the provision of turnaround finance to distressed firms within the South African context.

CHAPTER 3

3. RESEARCH QUESTIONS

3.1 Introduction

The overall research problem, “What are the factors which influence the provision of turnaround finance to financially distressed companies in South Africa?” is now formulated into specific research questions aimed at addressing the research objectives articulated in the first chapter. The overall research question is translated into research questions spanning the environmental factors, industry-specific factors, and individual firm-level factors which contribute to whether a distressed company can raise turnaround finance or not.

The study is exploratory in nature and as such the research problems detailed hereunder are intended to start a conversation which will lead to deeper understanding of the research problem at hand. This study will attempt to articulate the factors influencing whether capital providers extend turnaround funding or make an equity investment in a financially distressed company in SA. The factors will be considered within the context of macro-environment drivers, industry-specific considerations, and company-specific considerations influencing the provision of turnaround finance to distressed companies. The formulation of the research questions from the research objectives is detailed hereunder.

3.2 Research question formulation

In order to identify and investigate the factors contributing to the provision of turnaround finance to a distressed company, the following research objectives detailed in the first chapter are formulated into specific research questions to be addressed by this exploratory study.

3.2.1 Formulation of research question 1

Research objective 1: Determine what the macro-environmental drivers of turnaround finance in South Africa are. This research objective is restated as research question 1:

What are the macro-environmental factors which influence the provision of turnaround finance to distressed companies in South Africa?

3.2.2 Formulation of research question 2

Research objective 2: Examine to what extent the current and proposed legal frameworks as relates to turnarounds facilitate turnaround finance. This research objective is restated as research question 2:

Does the legal framework within which turnarounds take place in South Africa encourage or discourage the provision of turnaround finance to distressed companies?

3.2.3 Formulation of research question 3

Research objective 3: Determine whether industry specific factors are taken into consideration with respect to turnaround finance. This research objective is restated as research question 3:

Does industry-wide distress play a role in the provision of turnaround finance?

3.2.4 Formulation of research question 4

Research objective 4: Examine the risk and return considerations as relates to turnaround finance. This research objective is restated as research question 4:

What are the most pertinent risk and return considerations in relation to distressed investment from a capital provider's perspective?

3.2.5 Formulation of research question 5

Research objective 5: Identify the alternative forms of turnaround finance available to distressed companies in South Africa. This research objective is restated as research question 5:

How do distressed companies in South Africa finance turnaround plans in the absence of a 'debtor-friendly' bankruptcy code?

CHAPTER 4

4. RESEARCH METHODOLOGY

4.1 Introduction

The study sought to articulate the factors influencing the provision of turnaround finance to financially distressed companies in South Africa. The study was exploratory in nature, employing qualitative methodologies for analysis purposes in an effort to gain a deeper understanding of the research problem. Given that primary data on turnarounds is limited in developing countries (Pretorious and Holtzhauzen, 2008), elite interviews were conducted with experienced, senior executives within the professional fields of law, corporate finance, specialist finance, and turnaround management in an effort to incorporate a wider context in relation to the research problem and to gain access to information which the study would otherwise not have access to.

The method selected to conduct the elite interviews was a semi-structured interview format based on an interview guide developed by the author pursuant to the themes identified in the literature review. The interview guide is presented in Appendix 1 – Interview guide.

The following sub-sections in this chapter give a description of the research methodology adopted in the study, the population of relevance, and the unit of analysis for the study. The sample size, sampling method, research instrument, and the process of data collection are also detailed hereunder. The chapter concludes with a description of the limitations of the study.

4.2 Research Design and Methodology

The research sought to articulate the factors influencing whether capital providers extend turnaround funding or make an equity investment in a financially distressed company in SA. As stated by Pretorious and Holtzhauzen (2008, p91), primary data on turnarounds are limited (especially in developing countries), as failed firms disappear and successes are ascribed to the entrepreneur/manager or to leadership. Pretorious and Holtzhauzen (2008) employed the use of grounded theory research in their study. The grounded theory approach was considered for this study; however, the limited number of empirical studies into turnaround finance in developing economies would've proven to be a challenge in relation to the adoption of this design.

Zikmund (2003) advocated conducting exploratory research as a means of overcoming the existence of a limited amount of experience with or knowledge about a research problem. Given that there was limited evidence of research conducted on turnaround finance in South Africa, the research methodology undertaken was qualitative research in an exploratory design. As stated in Zikmund (2003) the reasons for embarking on qualitative or exploratory research are as follows:

1. Diagnosing a situation;
2. Screening alternatives; and
3. Discovering new ideas.

Exploratory research allows the researcher to engage in concept testing for the purposes of gaining a deeper understanding of the research problem (Zikmund, 2003). The research study undertaken sought to provide a preliminary understanding of the research problem which could stimulate further research on the topic as opposed to offering a conclusive or definitive finding and as such exploratory research was deemed the appropriate methodology to utilise in this respect. Furthermore, given the limited data available as stated in Pretorious and Holtzhauzen (2008), exploratory research facilitates the incorporation of emergent designs to data collecting procedures as new information comes to light during the research process (Welman and Kruger, 2001)

In order to pool data in the form of expert opinions on the factors influencing turnaround finance, elite interviews were conducted with experienced, senior executives within the professional fields of law, corporate finance, specialist finance, and turnaround management in an effort to incorporate a wider context in relation to the research problem and to overcome the limited data phenomenon relating to researching turnaround situations.

4.3 Population and Sampling overview

4.3.1 Target population overview

The population of relevance for the study was initially identified as South African companies (private companies, close corporations, and public companies excluding parastatals) which have successfully raised turnaround finance in the form of either debt or equity capital in the last two years. Given that accessing this data proved a challenge as South Africa does not have a database or registry of companies in judicial management, the population of relevance was further refined. The revised population of relevance for the study are senior executives within the professional fields of law (commercial and corporate), corporate finance, specialist finance, and turnaround management (practitioners and academicicians) who have experience in judicial management, informal creditor workouts, debt restructuring advisory services, corporate reorganizations and turnaround management. Senior executives are defined as members of an executive committee with respect to companies (CEO, head of business unit, executive director), senior partners with respect to law firms, and senior lecturers with respect to academicians. This target population was selected from a convenience point of view. In addition, by selecting the target population detailed above, the study managed to overcome the limited data phenomenon described earlier. The sampling frame was set as the Gauteng and Western Cape provinces of South Africa; more specifically, senior executives within the identified professional fields operating within the Gauteng or Western Cape province.

Three units of analysis were identified, as presented in Table 1 below. As detailed in table 1, the first unit of analysis relates to factors within the macro-environment which have an influence on the provision of turnaround finance. The second unit of analysis relates to industry-level factors which impact the ability of capital providers to provide turnaround finance. The third and final unit of analysis relates to company-specific attributes which make it possible for distressed companies to raise turnaround finance.

Table 1: Identified units of analysis

Identified unit of analysis	Description
Macro-environmental factors	Macro-environmental factors influencing turnaround finance
Industry factors	Industry-level factors influencing turnaround finance
Company-level factors	Company-specific factors influencing turnaround finance

4.3.2 Sampling overview

As stated above, the sampling frame was set as the Gauteng and Western Cape provinces of South Africa. The sampling for the study was conducted over two-phases as summarised in Table 2 below. Non-probability sampling was used for the first phase; in particular, Judgment or purposive sampling was employed to produce the initial respondent list as presented in Table 3 below (the primary respondent list). As stated in Zikmund (2003) judgment sampling is undertaken by a researcher to the extent that he/she believes that a sample should contain certain characteristics even if such a sample is not fully representative. The primary respondent list consists of senior executives within the professional fields of law, corporate finance, specialist finance, and turnaround management (practitioners and academicicians) who have experience in judicial management, informal creditor workouts, debt restructuring advisory services, corporate reorganizations and turnaround management. The initial sample was generated by consulting the Turnaround Management Association of Southern Africa's ("TMA-SA") member directory and identifying senior executives involved in turnaround finance and from the author's professional network.

Table 2: Summary of sampling phases and sampling technique

Research phase	Aim of phase	Data collection method	Sampling technique	Sample size
Phase 1	Expert opinion on factors influencing the provision of turnaround finance to distressed companies in SA	Semi-structured, elite interviews	Purposive	8 senior executives
Phase 2	Expert opinion on factors influencing the provision of turnaround finance to distressed companies in SA	Semi-structured, elite interviews	Snowball	2 Senior executives

In an effort to minimise sampling frame errors and selection bias with the primary respondent list, snowball sampling was employed in an effort to cast the *sampling net* wider and include additional respondents to enrich the study. The snowball sampling technique employed in phase 2 of the sampling exercise resulted in the development of a secondary (final) respondent list as presented in Table 4 below, based on information obtained during phase 1 as advocated in Zikmund (2003).

Table 3: Initial respondent list

Respondent	Designation	Company
Jamie Hollins	Executive Director	Growth Capital Partners
Claire van Zuylen	Senior Partner	Bowman Gilfillan
Stephen Brown	Executive Director	RMB Corvest
Johnny Philippou	Managing Director	Merchant Factors
Kevin Vlietman	Commercial Executive	TransUnion Credit Bureau
Marius Pretorius	Associate Professor in strategy and turnaround, Department of Business Management	University of Pretoria
Jan van der Walt	Chief Executive Officer	CRS Turnaround Management
Danile Nyalunga	Head of the Workout and Restructuring Strategic Business Unit (SBU)	Industrial Development Corporation

The need for a secondary respondent list was necessitated by the election by two of the identified respondents in the primary respondent list opting not to partake in the research study for varying reasons. One of the respondents referred the author to an alternative respondent who they believed was better placed to add value to the study. Additionally, the snowball sampling led to the identification of a respondent who was in the process of raising a distressed investment fund with one of the commercial banks in South Africa, who was included in the final respondent list. Given that the TMA-SA member directory listed 37 individuals describing themselves as investors or lenders (with a number representing the same organisation), the final respondent list was deemed to be fairly representative.

Table 4: Final respondent list

Respondent	Designation	Company
Jamie Hollins	Executive Director	Growth Capital Partners
Claire van Zuylen	Senior Partner	Bowman Gilfillan
Johnny Philippou	Managing Director	Merchant Factors
Michael Judin	Senior Partner	Goldman Judin Maisels Inc
Marius Pretorius	Associate Professor in strategy and turnaround, Department of Business Management	University of Pretoria
Jan van der Walt	Chief Executive Officer	CRS Turnaround Management
Danile Nyalunga	Head of the Workout and Restructuring Strategic Business Unit (SBU)	Industrial Development Corporation
Karl Gribnitz	Executive Director	Gandalf Trust

The data collection and analysis method employed in the study is presented in the next section.

4.4 Data Collection, Data Analysis, and Validity

Initial contact with the members of the primary respondent list was made telephonically. During the telephonic discussion, the author provided the identified respondents with a synopsis of the study and made an initial request for them to participate in the study. Once permission had been attained, a formal interview request and consent letter was sent for their consideration. Interviews were then set up on a one-on-one basis. Two of the initial respondents declined to participate in the study; one citing confidentiality concerns as the findings of the study would form part of the public information domain and another felt their participation wouldn't add value to the study as their knowledge on the subject matter was limited. With respect to the respondent with concerns regarding confidentiality, the author sought to reassure him that only aggregate findings would be presented and that anonymity of respondents could be accommodated and respected, however, despite this reassurance, the respondent elected not to participate in the study. The respondents who declined to participate in the study did however refer the author to other potential respondents to include in the study (snowball sampling) and this formed the basis for the final respondent list. In the end, five members of the final respondent list participated in the study. The finalisation of meeting dates with the other respondents proved to be a challenge due to their business commitments.

Semi-structured, elite interviews were conducted with the respondents in order to get a wider context of the research problem and in order to gain access to information which the study ordinarily wouldn't have had access to given the limited primary data on turnaround situations (Gillham, 2000). The interviews were semi-structured in order to facilitate knowledge sharing by the respondents while reserving the flexibility for the researcher to re-focus the interview on matters relevant to the research study. The interviews lasted between 30 and 60 minutes, with the average interview length being approximately 43 minutes. The interviews took place in either the office of the executive being interviewed or in a meeting room at the company where the executive is based. One of the interviews took place at the office of a client of one of the executives, a company undergoing a turnaround exercise. The interview guide as presented in Appendix 2 was used for the interviews, with the author assuming the role of the interviewer and providing the respondents with the context within which the research problem is being considered and the aim of the research. Permission was obtained from all the respondents to record the respective interviews. During the interview, the author made notes which were reviewed and augmented after the interview while listening to the audio recordings of the interviews.

The data was analysed by listening to the audio recordings of the interviews and making detailed notes of the discussion. The services of a professional transcriber were employed for the purposes of transcribing the audio recordings into text. The transcribed text was sent in draft form to the author for review and final amendments were made to the draft transcribed text by the author in order to ensure that the transcribed text was a verbatim account of the interview discussions. Some of the audio recordings exhibited poor audio quality and as such the transcriber was unable to transcribe the material into text effectively. In such instances, the author attempted to capture the essence of the discussion based on notes made during the interviews and on what was audible in the recordings. Please refer to Appendix 2 for the transcriptions. The entire volume of transcribed text was reviewed using *open coding* to get a generalised sense of the data (Henning, van Rensburg, and Smit, 2004). Content analysis methodology was then employed (Henning *et al.*, 2004) to code the data and assign specific meaning to the discourse of the recorded discussions. The different codes were then grouped and categorised according to their relatedness. To the extent that relatedness couldn't be established, subcategories were created and reviewed at the end of the categorisation exercise in order to re-assess their relatedness to the emerging main categories (emerging thematic pattern).

The thematic patterns were then clustered together according to the three identified units of analysis. The clustered themes were then related to the research questions in an effort to assess the extent to which they addressed the research problem. As stated in Parker, Guthrie, and Gray (1998), statistical tests for differences in exploratory studies with relatively small samples are deemed inappropriate and rather qualitative analyses of interviewee responses as conducted in this study are encouraged.

According to Mansourian (2007, p. 282), validity needs to be considered from there dimensions, namely:

1) neutrality (objectivity);
2) truthfulness (validity); and
3) replicability (reliability).

Objectivity was ensured through the constant review of the coding process detailed above. The result of this process is presented in Appendix 3. The validity of the study is assured through the submission of the actual audio recordings (including the inaudible recordings) for record purposes. The reliability of the study is enhanced through the detailed account of the research journey embarked on by the author within this chapter.

As only a few individuals were interviewed in the study, the ability to draw inferences about the population of relevance is admittedly limited. That said the themes identified and discussed in the next chapter could be expanded on in future research.

4.5 Assumptions and Potential Research Limitations

The potential limitations of the study relate to the sampling frame and the actual sample used in the study. Sampling frame error could have occurred as a result of setting the sampling frame as the Gauteng and Western Cape provinces. A study which extends the sampling frame may yield different results as the data collected would be generated from a greater pool. Additionally, the commercial activities and industries most dominant in a particular province could lead to the development of a sample bias when those provinces are considered on a stand-alone basis. This can be overcome through the extension of the sampling frame to cover all provinces in the country so as to eliminate the effect of these idiosyncrasies. That said the sampling frame error is reduced by the fact that the senior executives interviewed in the study are not restricted to operating in the two abovementioned provinces and as such their considered opinion can be generalised to the broader population from this perspective. A future research study relating the themes identified herein to an actual case study would be a means of testing said generaliseability.

An additional potential limitation of the study relates to an inherent nonresponse error resulting from the members of the respondent list who opted not to participate in the study and those who didn't participate in the study due to scheduling problems or non-contactability. Elite interviews are by their very nature subjective and as such the objectiveness of the study is enhanced through the inclusion of different perspectives on the subject matter so as to consider the research problem from all angles so to speak. Nonresponse error can influence the degree of objectivity achieved by a study to the extent that an important perspective is not captured by the study due to non response. The study conducted herein attempted to broaden the base of respondents so as to get a deeper understanding and broader context of the factors influencing turnaround finance in an effort to achieve objectivity hence judgement sampling was employed. A future research study extending the sample to include senior managers of distressed companies as part of the respondent base could enhance the objectivity of such a study.

4.6 Concluding Remarks on Research Methodology

The study employed an exploratory design and qualitative methodologies for analysis purposes in an effort to gain a deeper understanding and broader context of the research problem. Content analysis was used to analyse the data and the findings thereof are presented in the next chapter.

CHAPTER 5

5. RESULTS

5.1 Introduction

Content analysis was employed to code the data and assign specific meaning to the discourse of the recorded discussions. The different codes were then grouped and categorised according to their relatedness and subcategories were used where necessary to capture the emerging thematic pattern. The thematic patterns were then clustered together according to the three identified units of analysis. The clustered themes were then translated into identified contributing factors to the provision of turnaround finance. The identified factors were further categorised into whether they are positive or negative contributing factors when it comes to the influence they have on the provision of turnaround finance to distressed companies. The results of the interview analysis process are presented in Appendix 3. The main findings are presented in table format at the beginning of each subsection and discussed in detail within the relevant subsection. These results are now presented in relation to the identified units of analysis and the research questions.

5.2 Macro-environmental factors

The macro-environmental factors influencing the provision of turnaround finance to distressed companies are considered from a holistic perspective incorporating political, economic, social, technological, legal, and environmental factors ("PESTLE"). Given that research question 2 deals specifically with legal environment factors, the research findings pertaining to all other PESTLE factors are categorised within research question 1. With respect to legal environmental considerations, where the research results refer to a section of the Companies Act, the substantive provisions of the section are provided so as to give context to the results.

5.2.1 Research question 1: What are the macro-environmental factors which influence the provision of turnaround finance to distressed companies in South Africa?

a. Political factors

Table 5: Main political factors cited

POLITICAL FACTOR	RESPONDENT REFERENCE RATE
1) Job loss aversion	100%
2) Representation of Historically Disadvantaged South Africans in turnaround industry	40%

By far the most frequently mentioned macro-environmental factor with respect to facilitating the salvaging of corporate value through business rescue (financial distress turnaround) was the issue of job loss aversion. The avoidance of job losses stemming from the liquidation of distressed companies which could be rescued is both a social factor (as discussed further on in this chapter) and a political factor within the South African context due to the importance of trade unions within the South African political landscape. The respondents made mention of the influence of trade unions in the initial drafting of the white paper on business rescue which eventually became Chapter 6 of the Companies Act No. 71, 2008 ("Chapter 6" or "the Chapter") and how this influence has resulted in employee rights being catered for within the new legislation.

An additional contributing factor mentioned within the political domain is the issue of representation of historically disadvantaged South Africans ("HDSAs") within the turnaround industry. Claire van Zuylen makes mention of there not being an "*oversight body*" for business rescue practitioners as yet and goes on further to enquire, "*…if you say you have to be a chartered accountant or qualified lawyer, how do you bring into that HDIs?*". The turnaround industry would need to be compliant with transformation legislation within the country and the absence of clear qualification standards as determined by an oversight body could result in "*fronting scenarios*". The promotion of the inclusion of HDSAs in the turnaround industry is seen as a contributing factor towards the expansion of the turnaround skills base in South Africa.

b. Economic factors

Table 6: Main macro-economic factors cited

MACRO-ECONOMIC FACTOR	RESPONDENT REFERENCE RATE
1) Macro-economic instability	100%
2) Foreign Direct Investment	20%
3) Long-term viability of companies	20%
4) Entrepreneurship	20%

All the respondents made mention of the influence of the macro-economic environment as a contributing factor. As stated by Jamie Hollins, "*It is very topical and anyone can understand why as we are facing the worst economic recession in living memory. So turnarounds of businesses are a very common thing*". All respondents expected distressed companies to struggle to raise turnaround finance in the midst of a recession. This is due to a "*funding gap*" that exists currently in the market as financiers are themselves under pressure as mentioned by Danile Nyalunga and banks are "*tightening their lending restrictions and requirements*" according to Jamie Hollins. According to Jan van der Walt, to the extent that a company could raise turnaround finance in these macro-economic conditions, the terms thereof would be "*onerous*".

Macro-economic instability as characterised by, "*exchange rate volatility or high input costs*" as mentioned by Danile Nyalunga, can lead to the onset of financial distress even for economically viable companies. The broader macro-economic conditions would then make it difficult even for economically viable companies to raise turnaround finance. Jamie Hollins added that the broader macro-economic conditions affected "*the value of secured assets, particularly in a fire-sale situation where those assets are being auctioned*". This makes it difficult for financiers to extend turnaround finance as the value of secured assets decreases during economic downturns.

Claire van Zuylen introduced foreign direct investment as an economic variable which could be affected by the business recue provisions of Chapter 6, "*The liquidator* (turnaround practitioner) *has the power to suspend partially, or entirely, all or any provisions of a contract.*" Foreign investors have always relied on the enforceability of contracts as one of the attractions of investing their capital in South Africa. To the extent that the enforceability of contracts as relates to a company in Chapter 6 business rescue can be undermined by a turnaround practitioner, this could introduce an additional risk element to investing in South Africa, which could affect foreign direct investment.

Jan van der Walt mentioned two additional economic spin-offs which come into play in relation to turnarounds, being "*long-term viability of companies*" and "*entrepreneurship*". To the extent that companies in financial distress can effectively reorganise their affairs, this can stimulate entrepreneurship and result in the long-term economic sustainability of companies. The spin-offs thereof are the avoidance of job losses and contribution to GDP growth by facilitating the survival of economically viable companies.

c. Social factors

Table 7: Main social factors cited

SOCIAL FACTOR	RESPONDENT REFERENCE RATE
1) Job loss aversion	100%
2) Corporate culture dynamics	60%

As stated above, all the respondents mentioned the need to minimise job losses (job loss aversion) as a contributing factor from a social perspective. To the extent that ailing companies responsible for the employment of substantial workforces can be reorganised or rescued, the resulting avoidance of job losses leads to an easing of the already cumbersome social burden of unemployment.

60% of the respondents cited an aspect of South African corporate culture as a contributing factor. As stated by Claire van Zuylen, "*We don't have a culture of business rescue in South Africa.*", in making reference to judicial management. Jan van der Walt stated, "*We don't have a hire and fire culture.*" - A reference to the labour relations act. Additionally, Jan van der Walt mentioned that in South Africa, there is a "stigma associated with bankruptcy" which resulted in managers and/or shareholders of distressed companies being viewed as failures. In another reference to corporate culture within South Africa, Michael Judin stated, "*We don't have the culture in this country of angel* (investors) *who will take the risk on you. There are one or two venture capital funds that will take a risk for you but it is very difficult to find that money in South Africa.*" There are elements of South African corporate/business culture which are influenced by the legal framework within which we operate and this has given rise to social dynamics which influence turnaround finance.

d. Other factors

There was no mention of technological and/or environmental factors as contributors by any of the respondents.

5.2.2 Research question 2: Does the legal framework within which turnarounds take place in South Africa encourage or discourage the provision of turnaround finance to distressed companies?

According to van Zuylen and Harris (2009), reorganisations (turnarounds) of companies are dealt with under section 311 of the Companies Act 61 of 1973 (“the Act”), while the judicial management of companies is dealt with in terms of sections 427 to 440 of the Act. The Act has since been amended to incorporate business rescue as provided for in Chapter 6 of the Companies Act 71 of 2008. The results relating to the legal framework within which turnarounds take place are considered from both the ‘old’ Companies Act perspective as well as the ‘new’ Companies Act incorporating business rescue.

a. Judicial Management of companies

Table 8: Shortcomings of Judicial Management

FACTOR CITED	RESPONDENT REFERENCE RATE
1) Viewed as precursor to liquidation	60%
2) Criminal liability of directors	20%
3) High cost and administratively burdensome	20%
4) Preferential treatment of creditors not permitted	20%

The issue of director's responsibility was raised as an issue of concern for turnaround exercises. As stated by Claire van Zuylen, "*Directors could be held criminally responsible for continuing trading under financial distress*". Section 424 of the Companies Act provides that any person who was knowingly a party to the carrying on of the company's business in a reckless or fraudulent manner may be declared liable by the court for any or all of the debts or liabilities of the company (van Zuylen and Harris, 2009). The penalty for this offence is a fine or imprisonment for a period of not more than two years or both such a fine and imprisonment. The provisions of section 424 dissuade managers of distressed companies from seeking relief from their creditors for an interim period in order to turn the company around as the act of continuing to trade under these conditions could result in criminal charges being brought against them.

The issue of the high costs and administrative burden associated with judicial management was brought up as an influencing factor. Judicial management procedures can result in the incurrence of legal fees in excess of R200,000 and as such it is viewed as a mechanism available to "*big companies*" as small companies in distress would not be in a position to afford said fees.

The issue of judicial management being viewed as a pre-cursor to liquidation was cited. The majority of the respondents (60%) believed Judicial Management was viewed as tantamount to liquidation. Claire van Zuylen stated, "*creditors equate* *being in judicial management to winding up.*" Michael Judin augmented this argument by stating, "*There are very few instances of judicial management being successful. Most judicial management cases in South Africa will end in liquidation.*" The following comment from Jamie Hollins further enhances the argument, "*The problem is the complicated liquidation process that we have and at the end of that process would be the end of that company.*"

The issue of preferential treatment of new creditors (super-priority of turnaround finance) was cited as an influencing factor. A company in financial distress cannot grant preferential treatment to any of its creditors at the expense of its other creditors. A company in judicial management can obtain credit facilities but depending on the "wording of the judicial management order", the judicial manager may need to get a further court order approving the incurrence of further debt by the company (van Zuylen and Harris, 2009).

b. Business Rescue provisions of Chapter 6 of the Companies Act No. 71, 2008

All the respondents were familiar, to varying degrees with the business rescue provisions of Chapter 6. The provision of interest for the study was the section within the Chapter which relates to post-commencement finance (turnaround finance). The substantive expressions of the respondents most knowledgeable on the Chapter are presented herein.

Table 9: Considerations on Business Rescue provisions of Chapter 6

FACTOR CITED	RESPONDENT REFERENCE RATE
1) Super-priority status of post-commencement finance	60%
2) Ease with which companies can enter Chapter 6	40%

The issue of the super-priority status of post-commencement finance was cited as a contributing factor. As stated by Jan van der Walt, "*super priority status relates to the* (turnaround) *practitioner's fees and the* (company's obligations to it's) *employees…*" he goes on further to states, "*post-commence finance will have priority over pre-commencement creditors*".

The issue of the ease with which companies can enter Chapter 6 was raised as a contributing factor. According to Claire van Zuylen, all a company needs is an ordinary resolution passed by its board of directors declaring itself in financial distress and Chapter 6 proceedings can commence. She states, "…*you just file a resolution and you are in business rescue*…" This leaves Chapter 6 open to "*abuse*". This is a concern from a creditor point of view as the pendulum has swung in favour of the debtor with respect to bankruptcy resolution. According to Jamie Hollins, "*The problem with the provisions of Chapter 6 is that it doesn't provide the secured creditors with any greater security or support.*"

Despite the potential pitfalls of Chapter 6, the general view of the respondents was that it is a necessary evolution in the bankruptcy resolution system available in South Africa. As stated by Michael Judin, "*It is very early days to comment on* *business rescue but the theory on business rescue is good, because judicial management has failed in South Africa.*"

5.3 Industry-level factors

In addition to macro-environmental factors, industry or sector level considerations can play a role in whether turnaround finance is extended to a distressed company. The results with respect to industry level contributors are considered from an industry-wide economic distress perspective and from a risk and return perspective for capital providers. That is, the extent to which industry-wide phenomena play a role in influencing turnaround finance is considered within this section.

5.3.1 Research question 3: Does industry-wide distress play a role in the provision of turnaround finance?

Table 10: Factors relating to Industry-wide distress

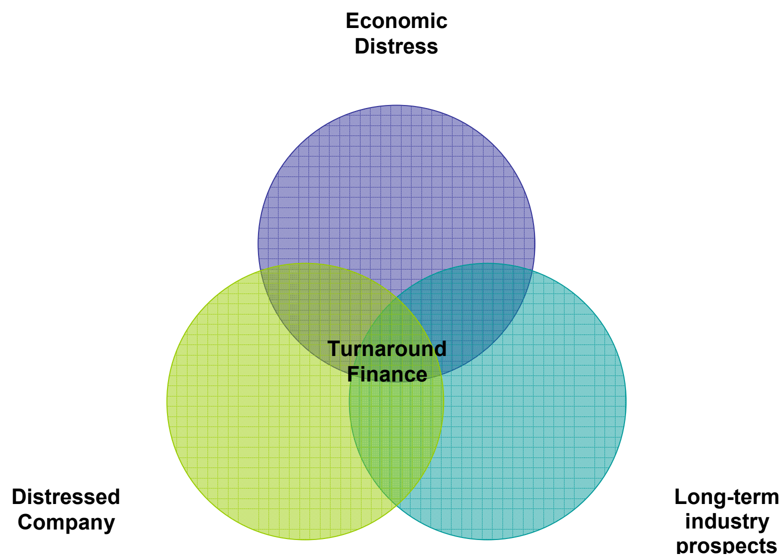
FACTOR CITED	RESPONDENT REFERENCE RATE
1) Economic viability of distressed company	60%
2) Long-term prospects of the industry	40%
3) Effect of industry-wide distress on asset values	20%

The economic viability of a distressed company was cited as an overarching contributing factor in relation to the effects of industry-wide distress on turnaround finance. Danile Nyalunga mentioned that the primary consideration is whether "*the client* (distressed company) *is viable going forward*". Furthermore, was the onset of financial distress brought about by a "*change in economic conditions?*" or an outdated business model? To the extent that the industry-wide distress is as a result of economic distress, financiers are likely to be more understanding.

The issue of the long-term prospects of the industry within which a distressed company operates was cited as a contributing factor. According to Jamie Hollins, financiers would be amenable to a compromise on existing credit terms "…*if the there were specific economic factors that indicate that the industry would improve over time*". Therefore, the issue of whether the industry-wide distress is brought on by adverse macroeconomic conditions or whether there is a fundamental weakness in the industry of reference are factors considered by financiers in making a determination as to whether to fund a distressed company or not (as presented in Figure 3 below).

The effect of industry-wide distress on asset values was also cited as a contributing factor as discussed in section 5.2.1. Depressed asset values diminish the collateral value of unencumbered assets which in turn has a bearing on the amount of turnaround finance a distressed company can raise.

Figure 3: Industry-wide distress dynamic



5.3.2 Research question 4: What are the most pertinent risk and return considerations in relation to distressed investment from a capital provider's perspective?

a. Risk considerations

Table 11: Risk considerations for capital providers

FACTOR CITED	RESPONDENT REFERENCE RATE
1) Competing interests between creditors and debtors	40%
2) No professional qualification standards	40%
3) Creditor coordination problem	40%
4) Enforceability of contracts	20%

The issue of which party's interests a turnaround manager represents was cited as a risk consideration from the perspective of both the legal frameworks detailed above (that is, judicial management and Chapter 6 business rescue). Claire van Zuylen compared the fiduciary duty of a judicial manager with that of a business rescue practitioner, "*…the judicial manager has a fiduciary duty to the creditors…the* (turnaround) *practitioner has a fiduciary duty to the company…what's best for the company may not be good for creditors*". This means that under judicial management, existing financiers could extend additional credit to a company in judicial management knowing full well that the judicial manager would act in their best interests; whereas under Chapter 6, the turnaround practitioner has a responsibility to act in the company's best interests and this may be at variance with the interests of creditors, particularly if this risk is considered in relation to the enforceability of contracts issue discussed hereunder.

The respondents mentioned that there isn't a uniform professional qualification required to be a judicial manager. "*Most of them tend to be accountants and lawyers*", however, the degree of their "*commercial sophistication*" can pose a risk for a potential capital provider to a distressed company. The development of a credible oversight committee is important to allay these concerns. Jan van der Walt mentioned a steering committee exists which is lobbying for the "*formalisation of qualifications within the turnaround industry*". Furthermore, there are plans afoot to introduce the "CTP" (Certified Turnaround Professional) designation in South Africa according to Jan van der Walt.

Creditor coordination was cited as a risk factor for capital providers. This creditor coordination problem is acute in informal creditor workouts. Major creditors (banks) with greater exposure to a distressed debtor company are usually willing to consider informal workouts; however, smaller creditors tend to adopt a harder line as their exposure to a distressed debtor could be the difference between profitability and financial distress. According to Claire van Zuylen, "…*so you often find your big creditors having to pay off your small guys, increasing their debt, but at least then they know there are no wild cards coming out of the left field to liquidate*." Michael Judin introduces the vested interest of legal advisors as a potential contributing factor with respect to small creditors scuppering informal workouts: "*Doing a deal* (informal workout) *with the company is much less appealing to the lawyer than liquidating. I'm sorry to say it but there will always be one lawyer with a client who can be influenced and will go across the company into liquidation.*"

Under Chapter 6, the turnaround practitioner has the power to suspend partially or entirely all or any provisions of a contract. This provision was cited as a risk consideration to the extent that a creditor has an existing exposure to a distressed company. To the extent that the turnaround practitioner can alter the provisions of an existing contract while a company is in business rescue, then this poses a risk to existing creditors of a distressed company. As stated by Claire van Zuylen, "*If banks are risk averse at the best of times, they are likely to be a 1000 times more risk averse once business rescue kicks in*".

b. Return considerations

Table 12: Return considerations for capital providers

FACTOR CITED	RESPONDENT REFERENCE RATE
1) Specialised field	100%
2) Ability to appoint new management	60%
3) Risk appetite of capital providers	60%
4) Priority ranking of turnaround finance facility	40%
5) Quality of information on distressed company	20%

All the respondents made mention of turnaround investment being a specialist field requiring specialised skills. As stated by Jamie Hollins, "*It does seem to be a specific specialist field…you need people with strong management and operational expertise*". In some instances, capital providers to a distressed company insist on a turnaround practitioner being appointed. All the respondents mentioned the need for the quality of management to be assessed by the capital provider before extending turnaround finance. Additionally, capital providers may seek to reserve the right to appoint a new management team to the extent that the current management team is found to be not up to scratch from a turnaround performance perspective.

The issue of the risk appetite of the capital provider was mentioned as a consideration. Turnaround finance is considered a risky asset class, albeit that "*venture capital is the riskiest form of private equity*" as stated by Jan van der Walt and as presented in Figure 2 in the first chapter. The risk appetite or risk tolerance of the capital provider will determine whether they extend turnaround finance or not. In informal creditor workouts, debt-to-equity swaps (that is exchanging a debt claim in a company for an equity interest of similar value) are driven by the risk appetite of secured creditors and their belief in the management team. Danile Nyalunga mentioned that debt-to-equity swaps are complicated by the challenge posed by valuation of distressed companies. With respect to financial institutions (banks), their risk appetite tends to be low. As stated by Michael Judin, "…*the banks all work off the same model and there is this aversion to risk, it is going to be almost impossible to obtain those funds* (turnaround finance)".

Priority ranking of turnaround finance was cited as an influencing factor in relation to financiers assuming the risk of extending turnaround finance to distressed companies. As stated by Danile Nyalunga, "…*our funding may need to rank ahead of existing loans…or rank the same as existing lenders*". As stated above, Chapter 6 makes provision for post-commencement finance to rank ahead of pre-commencement creditor claims. According to Danile Nyalunga the IDC has set aside R6.1 Billion to assist distressed companies. This facility is used to extend financial assistance to "*clients in the IDC's* (lending) *book…and* *new clients*". The risk appetite of lenders such as the IDC which is a development finance institution tends to be higher than commercial banks. Equally, different types of financiers have different mandates which may influence the degree of risk taking they are willing to engage in.

Jan van der Walt referred to "*time being of the essence*" when it comes to potential equity investors (distressed investors) making a decision as to whether to acquire an equity interest in an ailing company. The due diligence exercise performed by private equity investors is time consuming and this assessment time, which is necessary from a private equity investor's perspective, is time that a distressed company may not have as typically the need for fresh capital injection is urgent. The increased assessment time is as a result of the quality of information from distressed companies being poor. Jan van der Walt mentioned "*pre-negotiated*" bankruptcy sales (pre-packaged bankruptcies) as an alternative model which can facilitate distressed investment. This model would deal with the concerns relating to assessment time as the private equity investors would assess the company at the same time as the bankruptcy plan is being negotiated and finalised between the practitioner and the creditors.

5.4 Company-level factors

In addition to the industry-level considerations, company-level factors or attributes often come into play when capital providers consider providing turnaround finance to a distressed company. The results with respect to the company level contributors are considered in relation to how financially distressed companies in South Africa manage to raise turnaround finance in a 'creditor' friendly environment.

5.4.1 Research question 5: How do distressed companies in South Africa finance turnaround plans in the absence of a 'debtor-friendly' bankruptcy code?

Table 13: Sources of funding for distressed companies

SOURCES CITED	RESPONDENT REFERENCE RATE
1) Internal forms of funding	100%
2) Existing financiers	100%
3) Private equity investors	100%

All the respondents mentioned internal forms of funding as being the primary source of turnaround finance for distressed companies in South Africa. The most common forms of internal funding (that is, funds generated internally by a company in distress rather than sourced from third parties) as mentioned by the respondents were cost reduction and asset disposal. Although, as stated above, asset sales in a depressed market can yield below market value realisations which may undermine this form of internal funding. The findings indicate that distressed companies look to their labour force when considering cost reductions. As stated by Claire van Zuylen, *"…you may need to retrench 25%* (of your workforce) *in order to save 75%...*" This statement further emphasises the social impact in relation to job losses posed by distressed companies.

The issue of third party funding was cited as a source of turnaround finance. The respondents held a view that the best placed third party financiers for a company in distress were its existing financiers. As stated by Jamie Hollins, "*Rather approach a financier who understands the company, who has history with the company, who has a track record with the company and who has been with the company for a while and knows what is necessary to get the business through*." Economic viability of the company and the quality of its management team were mentioned by the respondents as the key areas of assessment financiers focused on when considering extending turnaround finance to a distressed company. As stated by Jamie Hollins, "…*the existing financiers are far more willing to consider comprises, write downs of bad debts, extensions of debt terms, interest rate holidays.*" These are the forms of third party financing which are available to distressed companies in South Africa currently. A moratorium on capital and interest repayments is another form of third party facilitation afforded to distressed companies as mentioned by the respondents. In some cases, the third party providing turnaround finance may dictate what the funds can be used for, that is, for working capital purposes, for the financing of expansion plans, and for the investment into plant and equipment aimed at turning around the fortunes of the ailing company. According to Danile Nyalunga, turnaround finance "…*is coming in to assist the business…not the shareholders*"

The issue of monitoring distressed companies was mentioned as well. Jamie Hollins adds, "…*the banks themselves are the most well equipped and have to* *step in and try and help that business in its turnaround strategy*". The monitoring role is either performed by the bank or a turnaround practitioner appointed by the bank.

Private equity investors were cited as yet another source of turnaround finance. In this instance, the private equity investor would seek a return commensurate with the risk they are assuming. As stated by Danile Nyalunga, "…*but there as well, if you look at the returns they* (private equity investors) *are asking for they are huge as well*…" The returns associated with investing in distressed companies can be substantial if the distressed investor is in a position to reorganise the company successfully and invest at the time of reorganising at a discounted value (fallen angel effect).

5.5 Concluding remarks on the results

The results of the study were considered from the overarching perspective of the three identified units of analysis, with the data clustered around the research questions. The key findings were considered within the context of the PESTLE model, with the findings indicating that the non-legal environment factors of interest are political factors, economic factors, and social factors. The results with respect to industry level contributors were considered from an industry-wide economic distress perspective and from a risk and return perspective for capital providers. The results with respect to the company level contributors were considered in relation to how financially distressed companies in South Africa manage to raise turnaround finance in a 'creditor' friendly environment. The results are analysed and related to the reviewed literature in the next chapter.

CHAPTER 6

6. DISCUSSION OF RESULTS

6.1 Introduction

This chapter will discuss the results in relation to the literature review, to determine the extent to which the results are in accordance or at variance with the literature reviewed. The chapter discusses the results in the context of the research questions posed. The results are discussed within the context of macro-environmental factors, industry-level factors, and company-level factors. The results are related to the respective research questions and initial research objectives at the end of each subsection. The research questions are answered or addressed in the concluding remarks of each subsection hereunder.

Given the small sample size used in the study, the ability to draw inferences about the population of relevance is admittedly limited. That said the outcomes as discussed in this chapter could be expanded on in future research.

6.2 Macro-environmental factors

The results of the study as relates to macro-environmental factors are considered from a political, economic, social, and legal dimension.

6.2.1 Research Question 1: What are the macro-environmental factors which influence the provision of turnaround finance to distressed companies in South Africa?

As presented in Chapter 5, the study identified a number of macro-environmental factors which have an influence on turnaround activity within South Africa, and by inference, on turnaround finance as well. The key findings were considered within the context of the PESTLE model, with the findings indicating that the non-legal environment factors of interest are political factors, economic factors, and social factors. The findings with respect to each of the identified macro-environmental factors are discussed hereunder.

a. Political factors

The study identified job loss aversion and the representation of Historically Disadvantaged South Africans (“HDSAs”) as the key contributing factors from a political environment perspective. The identified contributing factors affect turnaround finance indirectly as it is the convergence of the pressure exerted by these two factors within a South African context, which has influenced, in part, the enactment of legislation aimed at facilitating business rescue. Smith and Stromberg (2004, p. 13) suggested that an efficient bankruptcy code is one which, amongst other things, accommodated the interests of “involuntary” claimholders on the distressed company, such as current employees and other stakeholders. The contributions to the early drafts of the business rescue provisions by trade unions, motivated by a desire to avert job losses resulting from the liquidation of distressed companies, can be interpreted as a macro-driver in relation to the enactment of bankruptcy legislation aimed at encouraging ex-post bargaining efficiency (Smith and Stromberg, 2004).

The representation of HDSAs within the turnaround industry is less of a macro-driver in this regard, however, the pressures exerted by the need to encourage inclusivity of all members of South African society in different professional codes will result in a broadening of the base of turnaround skills in the country and this can only benefit turnaround activity.

Based on these considerations, job loss aversion as a political construct is deemed a contributing factor from a macro-environmental perspective.

b. Economic factors

The study identified macro-economic instability, foreign direct investment, long-term viability of companies, and entrepreneurship as contributing factors from a macro-economic environment perspective.

Macro-economic instability was identified as manifesting the form of exchange rate volatility, high input costs, and depressed asset values. This is in accordance with the reviewed literature (Koopman and Lucas, 2005; Acharya, Bharath, and Srinivasan, 2007). Macro-economic instability results in both increased incidences of bankruptcies (Statistics South Africa, 2009) and tighter credit conditions which make it difficult for distressed companies to raise turnaround finance. The effect of macro-economic instability on increased incidents of bankruptcies is more pronounced in a country like South Africa, which has a 'creditor-friendly' bankruptcy resolution legal system (Bhattacharjee, Higson, Holly, and Kattuman, 2009).

The power availed to a business rescue practitioner to amend contracts, partially or in full, was identified as a provision which could potentially affect foreign direct investment. This needs to be considered in the context of the prevalent bankruptcy code in a country. Both Dal Pont and Griggs (1996) and Smith and Stromberg (2004) argue for a bankruptcy code that addresses the misalignment of interests between creditors and debtors in a distressed situation and allows for bargaining and optimal value recovery is such circumstances. The interests of foreign investors are arguably better served by a bankruptcy code which resolves the misalignment of interests and allows for bargaining and maximisation of value recovery in the event of distress. The literature reviewed did not consider the direct influence of 'debtor-friendly' bankruptcy resolution mechanisms on foreign direct investment and as such the explanatory power of this consideration cannot be empirically justified.

The indirect benefits to an economy of an efficient bankruptcy code were identified in the study as being long-term viability of companies and encouragement of entrepreneurship. When considered within the literature cited in this subsection, these indirect benefits are justifiable; however, they aren't an influencing factor on turnaround finance but rather a beneficiary of a bankruptcy code which facilitates turnaround finance. In such a bankruptcy code, a fresh start, for entrepreneurs and distressed companies alike, is possible.

c. *Social factors*

The social factors identified in the study are job loss aversion and corporate culture dynamics. Job loss aversion, as discussed above, is deemed a contributing factor in relation to turnaround finance albeit indirectly.

The cultural dimensions of interest as identified by the study relate to turnaround management facilitation, labour force flexibility, and risk capital formation. These findings need to be considered within the context of the legal framework within which turnaround activity has taken place in the past in South Africa. These dimensions are covered in other subsections of this chapter.

Concluding remarks on research question 1:

The macro-environment drivers of turnaround finance in South Africa can be categorised into direct and indirect influencing factors. The direct influencing factors are macro-economic instability which manifests in the form of exchange rate volatility, high input costs, and depressed asset values. These factors result in increased incidents of financial distress which in turn results in increased bankruptcies, tightening credit conditions, and lower default recoveries. In such circumstances the need for turnaround finance is acute. Indirect influencing factors exist in the form of the political and social pressure exerted by the risk of job losses which has played a role in the enactment of a ‘debtor-friendly’ bankruptcy resolution legal system.

6.2.2 Research Question 2: Does the legal framework within which turnarounds take place in South Africa encourage or discourage the provision of turnaround finance to distressed companies?

As presented in Chapter 5, the study considered the legal framework within which turnarounds take place both in relation to judicial management as a bankruptcy resolution mechanism and business rescue as a bankruptcy resolution mechanism.

a. Judicial management of companies

The contributing factors of interest as relates to judicial management were identified as follows:

1) Judicial management is viewed as a precursor to liquidation;
2) The reckless trading provisions of section 424 discourage business rescue;
3) Judicial management is costly and administratively burdensome; and

4) Preferential treatment of creditors is not permitted under judicial management.

Judicial management as a bankruptcy resolution mechanism failed to encourage ex-post bargaining efficiency (Smith and Stromberg, 2004) and to facilitate the competitive bidding for a distressed company (Dal Pont and Griggs, 1996). Judicial management was 'creditor-friendly' and empirical evidence suggests that for a developing economy, the optimal bankruptcy code is one with both a creditor friendly chapter and a debtor friendly chapter (Berkovitch and Israel, 1999). As indicated by 60% of the respondents, judicial management failed to address the creditor coordination problem, alignment of competing interests between creditors and debtors, and the resolution of the information asymmetry problem between creditors and debtors.

The shortcoming of a bankruptcy resolution mechanism which is too hasty in its encouragement of the liquidation of a distressed company is that recovery rates aren't maximised due to the information asymmetry between creditors and debtors (Kahl, 2002). To the extent that most judicial management cases end in liquidation this serves to discourage corporate value recovery in distressed companies. This supports the earlier assertions with respect to there not being a culture of business rescue in South Africa.

Additionally, the costs associated with the procedure make it a prohibitive bankruptcy resolution mechanism as relates to small companies. Thorburn (2000) found that the Swedish auction bankruptcy system was an efficient mechanism for resolving bankruptcy for small companies. The system had lower costs and absolute priority rules (ranking of claims against a distressed company) were maintained. This resulted in recovery rates similar to Chapter 11 cases.

The findings in relation to the use of judicial management as an efficient bankruptcy resolution mechanism are at variance with what's contained in the literature with respect to what constitutes an efficient bankruptcy resolution system.

b. Business rescue provisions of Chapter 6

In a study that compares the bankruptcy systems in six different countries: France, Germany, Japan, Sweden, the United Kingdom, and the United States, Smith and Stromberg (2004) found that efficient bankruptcy systems ensure the going concern value of a distressed company during the procedure and encourage competitive bidding for the reorganisation of the distressed company. The findings of this study in relation to the business rescue provisions of Chapter 6 are that the new bankruptcy code in South Africa will facilitate the provision of post-commencement finance which will rank ahead of pre-distress liabilities and that it has a number of 'debtor-friendly' provisions; such as a simplification of the procedure to institute business rescue (turnaround). The post-commencement finance provisions will ensure the going concern value of the distressed company during the procedure as will the simplification of the process for instituting business rescue procedures.

The study also highlighted that business rescue is in its infancy as it is not effective yet. The study found that there are a number of regulations which still need to be enacted to support the implementation of the new business rescue chapter within the Companies Act. Though there are some perceived shortcomings in relation to its planned implementation, the study did highlight that it was a necessary evolution in bankruptcy laws in South Africa as judicial management was not effective at encouraging business rescue.

Concluding remarks on research question 2:

Judicial management does not encourage turnaround finance as it is equated to a company being liquidated. The limited cases of successful judicial management only serve to exacerbate the belief that judicial management is a precursor to liquidation. This observed failure of the system contributes to the view that South Africa does not have a business rescue culture.

The business rescue provisions of Chapter 6, on the other hand, are viewed as encouraging. In particular the provisions relating to post-commencement finance and the simplification of the procedure to institute business rescue are viewed as encouraging, albeit that they are vulnerable to abuse or misuse. There are a number of identified implementation hurdles which need to be addressed prior to Chapter 6 taking effect. Despite these observed shortcomings, Chapter 6 is viewed as a necessary evolution of the country's bankruptcy laws as judicial management hasn't been effective in encouraging business rescue.

6.3 Industry-level factors

The results with respect to industry level contributors are considered from an industry-wide economic distress perspective and from a risk and return perspective for capital providers.

6.3.1 Research Question 3: Does industry-wide distress play a role in the provision of turnaround finance?

The study found the economic viability of a distressed company to be an overarching contributing factor in relation to industry-wide distress. Glasserman (2005) found that financial institutions considered aggregate credit portfolio risk as well as the marginal risk posed by an individual counterparty or counterparties in their capital allocation decisions. The findings of the study are at variance with the findings of Glasserman (2005), however, this could be due to the respondents within the study not being commercial bank executives. One of the respondents is an executive at a Development Finance Institution ("DFI"), which has a different mandate with respect to capital allocation decisions as compared to a commercial bank. This funding mandate dynamic could cloud the findings of the study. The findings of the study are in line with the findings of Carey, Post, and Sharpe (1998) and Evans and Koch (2007) as relates to the avoidance of exposure to risky clients by banks in favour of specialist finance companies. Therefore, the findings of the study in relation to the overarching influence of economic viability and the consideration of the distressed industry's long-term prospects in credit decisions applies more to specialist finance companies as opposed to banks.

The study found that adverse macro-economic conditions resulted in depressed asset values which weakened the collateral base for distressed companies seeking turnaround finance. Using data on defaulted firms in the United States over the period 1982–1999, Acharya, Bharath, and Srinivasan (2007) found that recoveries on defaulted debt were affected by macroeconomic instability as well as industry-wide distress. The findings of Acharya et al (2007) support the findings of this study.

Concluding remarks on research question 3:

Industry-wide distress plays a role in the provision of turnaround finance by commercial banks as the marginal risk contribution of a company within a distressed sector could have a bearing on the Value-at Risk (VaR) of their total credit portfolio. Specialist finance companies and DFIs would seek to satisfy themselves of the economic viability of the distressed company and the distressed industry's long-term prospects prior to providing turnaround finance.

Industry-wide distress does have a bearing on asset values and this results in diminished collateral capacity of a distressed company's unencumbered assets, making it difficult for the company to raise turnaround finance.

6.3.2 Research Question 4: What are the most pertinent risk and return considerations in relation to distressed investment from a capital provider's perspective?

a. Risk considerations

The study identified the following key risk considerations from a capital provider's perspective:

1) Competing interests between creditors and debtors;
2) The lack of uniform professional qualification standards;
3) Creditor coordination problems; and
4) Enforceability of contracts

The study found that the interests of creditors and debtors are often at variance in distressed situations as both parties are attempting to maximise value recovery for themselves. This competing interest dynamic can be further exacerbated by the creditor coordination problem. Kahl (2002) proposed a dynamic liquidation model which would address this trust breakdown between creditors and debtors. The model is aimed at bridging the information asymmetry between the two parties and optimising value recovery for both parties. Furthermore, as stated by Smith and Stromberg (2004), an efficient bankruptcy law should mitigate the bargaining frictions between creditors and debtors. The findings within the literature concur with the findings of the study as to the competing interests of creditors and debtors in bankruptcy reorganisation. That said, the findings in the literature suggest that the competing interests can be addressed through the adoption of a dynamic liquidation model in the absence of a bankruptcy code which facilitates the mitigation of bargaining frictions in bankruptcy reorganisations.

The study found that the creditor coordination problem can lead to the liquidation of a company which could have otherwise been saved. This finding is consistent with empirical data (Kahl, 2002). The literature confirms that the creditor coordination problem can be acute in developing economies due to increased information asymmetry between creditors and debtors (Berkovitch and Israel, 1999).

The study found that there are no uniform professional qualification standards for judicial managers in South Africa at present and for turnaround practitioners as relates to Chapter 6. This is a risk factor for capital providers due to turnaround management being a specialised field, requiring prior acquisition experience in order to successfully implement turnaround transactions (Bruton, Oviatt, and White, 1994). The study highlighted that this risk factor is in the process of being resolved.

The study identified that the provision within Chapter 6 which relates to the power of the turnaround practitioner to amend the enforceability of contracts poses a risk to capital providers and this would lead to heightened risk aversion on their part. This is in accordance with the findings of Carey *et al* (1998).

b. Return considerations

The study identified the following key return considerations from a capital provider's perspective:

1) Distressed investment is a specialised field;
2) Ability to appoint new management;
3) Risk appetite of capital providers;
4) Priority ranking of turnaround finance facility; and
5) Quality of information on distressed company.

As discussed above, the findings of Bruton *et al* (1994) highlight the need for prior acquisition experience and knowledge of the industry concerned in order to successfully integrate acquired distressed companies, making distressed investment a specialised field. From a returns consideration, the study found that this experience is necessary in order to successfully navigate the corporate reorganisation of a distressed company by an investor.

The study found that investors in distressed companies would seek the right to appoint a new management team to the extent that they were not satisfied with the abilities of the present management team. This finding is supported by the findings of Hotchkiss and Mooradian (1997), whereby the post-restructuring stock and bond returns were greater for distressed companies where a “vulture” investor took up the position of CEO or Chairman or took up an active managerial role. The Hotchkiss and Mooradian (1997) study signifies the importance of prior acquisition experience in relation to positive returns generation from a distressed investment perspective.

The study found that risk tolerance in relation to potential realisable returns came into play when existing financiers of a distressed company considered whether to provide the company with turnaround finance or whether to convert their liability exposure into an equity interest in the distressed company (debt-to-equity swap). Numerous studies indicate the potential returns from investing in distressed companies can be substantial (Indro, Leach, and Lee, 1999; Russel, Branch, and Torbey, 1999). As documented in the literature (Gilson, Hotchkiss, and Ruback, 2000; Damodaran, 2002) valuation of distressed companies is challenging. The study findings are in accordance with the valuation challenges expressed in the literature. Additionally, the study findings suggest that 'creditor-friendly' bankruptcy resolution systems, creditors have no incentive to resolve bargaining frictions through debt-to-equity swaps as recoveries can be executed through liquidation as discussed above in relation to creditor coordination problems.

The study found that priority ranking of post-commencement finance or turnaround finance was an important decision influencing factor for capital providers. Indro *et al* (1999) confirm that the preferred investment for investors in distressed companies are distressed debt issues, which later evolve into equity interests once the company has reorganised. Skeel (2003) found that priority ranking of DIP loans could result in an over-investment (excessive risk taking) incentive for management. This phenomenon further enhances the need for distressed investors to reserve the right to appoint new managers in a distressed company as discussed above. The allowance for priority ranking of turnaround finance may result in managers of distressed companies engaging in strategic information dissemination as discussed hereunder.

The study found that the quality of information from distressed companies was poor and as such, investors in distressed companies needed to conduct detailed due diligence exercises which are time consuming. In a distressed situation, time is of the essence and this additional assessment time could result in the liquidation of the distressed company by a judicial manager while the information is being considered or gathered. Gilson (1995, p. 13) found that the risks of investing in a distressed company could be mitigated through “careful planning” and “adequate” due diligence. This is in accordance with the findings of the study. Furthermore, Gilson *et al* (2000, p. 70) found that management and shareholders of distressed companies provided information with “strategic biases” in bankruptcy filings, due to the conflicting interests between them and creditors and this undermined the quality of information received from a distressed company. The study found that the information quality dynamic could be addressed through the use of pre-packaged bankruptcies as an alternative form of distressed investment.

Concluding remarks on research question 4:

The decision to provide turnaround finance is influenced by a number of risk and return considerations. The most pertinent risk considerations are whether the financier’s interests will be protected throughout the reorganisation process, whether the turnaround practitioner presiding over the reorganisation process is adequately qualified, whether creditors will support the reorganisation plan and postpone their liquidation order decision, and whether contractual obligations will be honoured during the reorganisation process. These risks need to be considered in relation to the potential upside, in the form of excessive returns, presented by investing in a distressed company (the fallen angel effect).

The most pertinent return realisation considerations are the ability for the distressed investor to appoint new management and take an active role in the distressed company, priority ranking of the turnaround finance facility, and the quality of information provided as this may distort valuation of the distressed company.

6.4 Company-level factors

The results with respect to the company level contributors were considered in relation to how financially distressed companies in South Africa manage to raise turnaround finance in a ‘creditor-friendly’ environment.

6.4.1 Research Question 5: How do distressed companies in South Africa finance turnaround plans in the absence of a ‘debtor-friendly’ bankruptcy code?

The findings of the study in relation to sources of turnaround finance for distressed companies were as follows:

1) Internal forms of funding;
2) Existing financiers; and
3) Private equity investors

The study identified internal forms of funding as being the primary source of turnaround finance for distressed companies. In particular, the forms of internal funding employed by companies, were cost reduction and asset disposal.

Evidence in the literature supports this finding (Denis and Rodgers, 2007) and additionally points to the size of the company playing a role in a distressed company's source of finance (Evans and Koch, 2007). Evans and Koch (2007) found that small companies were more likely to receive turnaround finance from their suppliers as opposed to banks.

The study found that existing financiers were more likely to extend finance to a distressed company they already had an exposure to in an effort to maximise their recovery rate and protect their value. The funding can take the form of a moratorium on debt repayments, a write-down of the liability outstanding, an extension of the term of the facility, or an extension of additional credit on the back of unencumbered assets. As indicated in earlier parts of this chapter, macro-economic conditions have a bearing on the ability of distressed companies to offer unencumbered assets as collateral and preferential treatment of creditors by a distressed company is not permitted. These two factors could restrict the ability of a distressed company to secure turnaround finance on the back of unencumbered assets. The finding in relation to securing turnaround finance from existing lenders is consistent with the literature (Elayan and Meyer, 2001). Interestingly, Chatterjee, Dhillon, and Ramirez (2004) found no evidence of wealth transfers from junior to senior debt-holders, meaning that unsecured creditors were not prejudiced by the priority ranking of DIP loans. The implications of the findings of the Chatterjee *et al* (2004) study are that unsecured creditors' rights and recovery value aren't affected by the with the preferential treatment of turnaround financiers, to the extent that the turnaround exercise is successful.

The study found that existing financiers monitored the performance of distressed companies through the reorganisation process through internal divisions referred to as “intensive care” divisions or alternatively through the appointment of a turnaround practitioner to guide the distressed company through the reorganisation period. Chatterjee *et al* (2007) found that the provision of DIP financing helped resolve the information asymmetry between managers and creditors and as such the study findings are in accordance with the literature.

The study identified private equity investors as an additional source of turnaround finance. The findings of the study highlighted the need for the returns achieved by private equity investors to be commensurate with the risk they are assuming by investing in a distressed company. As stated above, a number of studies indicate that the potential returns from investing in distressed companies can be substantial (Indro *et al*, 1999; Russel *et al*, 1999). As such the research findings are supported by the literature.

Concluding remarks on research question 5:

There are three main sources of turnaround finance for distressed companies in South Africa: internal forms of funding, existing financiers, and private equity investors. Internal forms of funding take the form of cost reduction and asset disposal. Existing financiers are more likely to provide turnaround finance to an existing client in financial distress. This funding takes the form of either relaxation of current funding terms or the provision of new facilities on the back of unencumbered assets. The value of unencumbered assets can be affected by macro-economic conditions; furthermore, the ability of a distressed company to use unencumbered assets as collateral for turnaround finance is restricted in law. Private equity investors, on the other hand, require returns commensurate with the risk they are assuming and as such tend to be selective in the distressed companies they are willing to invest in.

6.5 Concluding remarks on results

The findings of the research study were considered in relation to the literature reviewed. For the most part, the findings of the research study were consistent with the literature reviewed. The research study addressed the research objectives, albeit with a small sample.

Given the small sample size used in the study, the ability to draw inferences about the population of relevance is limited. The research study findings would need to be expanded on by future research in order to enhance the generaliseability of the findings.

CHAPTER 7

7. CONCLUSION

7.1 Introduction

There is a great deal of literature on turnaround management, optimal bankruptcy laws, debtor-in-possession finance, creditor-friendly versus debtor-friendly bankruptcy laws, and distressed investment. The majority of the literature is based on findings as relates to Chapter 11 bankruptcies in the USA or bankruptcy resolution systems in developed economies. Literature on turnarounds in developing countries is limited but is increasing with each passing year as bankruptcy resolution becomes more prevalent globally. Given the current global financial crisis, interest in turnarounds both from an academic as well as from a practitioner perspective, and particularly in developing economies like South Africa, is growing. In light of this, the research question was posed: what factors influence the provision of turnaround finance to financially distressed companies in South Africa? This research study has embarked on an exploratory journey to attempt to articulate the key influencing factors in this regard and to identify what sources of turnaround finance are available to financially distressed companies in South Africa.

The study found that the factors which influence the provision of turnaround finance to financially distressed companies exist on three levels, namely: Macro-environmental factors, Industry-level factors, and Company-level factors. The findings of the study could be of interest to turnaround practitioners and consultants in general, keen on getting a sense of what influences the provision of turnaround finance on these three level and how distressed companies are able to raise turnaround finance. Additionally, the research findings could be of interest to shareholders and managers of distressed companies interested in understanding what the key considerations are with respect to the provision of turnaround finance from a capital provider's perspective and what the sources of turnaround finance in South Africa are.

The findings of the study are distilled into broad recommendations for shareholders or managers of distressed companies to consider in their attempts to raise turnaround finance. The recommendations are presented in relation to macro-drivers of turnaround finance, risk and return considerations of capital providers with respect to the provision of turnaround finance, and the different sources of turnaround finance. The chapter also contains suggestions for future research, particularly with due regard to the limited generaliseability of the results of the study.

7.2 Recommendations

The recommendations presented herein relate to the substantive factors of interest to distressed companies attempting to secure turnaround finance.

7.2.1 Macro-drivers of turnaround finance

The macro-drivers which affect turnaround finance directly are macro-economic conditions and legal considerations.

1) Macro-economic conditions

The macro-environment drivers of turnaround finance in South Africa can be categorised into direct and indirect influencing factors. The direct influencing factors are macro-economic instability which manifests in the form of exchange rate volatility, high input costs, and depressed asset values. These factors result in increased incidents of financial distress which in turn results in increased bankruptcies, tightening credit conditions, and lower default recoveries. In such circumstances the need for turnaround finance is acute.

Recommendations for shareholders and managers:

To improve the likelihood of raising turnaround finance during periods of macro-economic instability, shareholders and managers of distressed companies need to assess the value of their unencumbered assets and review the company's liability exposure to secured and trade creditors. To the extent that the distressed company has unencumbered assets, same can be utilised as security for turnaround finance. Equally, the shareholders or managers of a distressed company could attempt to renegotiate terms with financiers while instituting business rescue.

2) Legal considerations

The research study found that there are a number of laws relating to bankruptcy resolution. The key sections of the Companies Act which relate to turnarounds and turnaround finance are the business rescue provisions of Chapter 6 and within that the post-commence finance provisions of the Chapter. The study found that the information asymmetry between creditors and managers of distressed companies and problems of creditor coordination often resulted in creditors instituting liquidation proceedings prematurely without considering whether corporate value of a distressed company can be salvaged.

Recommendations for shareholders and managers:

Information asymmetry between creditors and the managers of distressed companies can be resolved through the adoption of a dynamic liquidation model as presented by Kahl (2002), which affords creditors the opportunity to gather more information on the distressed company in exchange for the creditors postponing their right to institute liquidation proceedings. The creditor still retains the right to liquidate, but at least they will be in a position to base the liquidation decision on better quality information and potentially maximise their recovery through seeing the company through the reorganisation process.

The creditor coordination problem can either be resolved through the use of pre-packaged bankruptcy as a means of managing the misalignment of creditor interests. Alternatively, as detailed by one of the respondents, secured creditors could make an offer to the unsecured creditors in an effort to resolve the coordination problem. In order for the secured creditors to facilitate this resolution of the creditor impasse, they would need to be satisfied as to the economic viability of the distressed company.

7.2.2 Risk and return considerations of capital providers

1) Risk considerations

The most pertinent risk considerations from a capital provider's perspective as identified in the study are whether the financier's interests will be protected throughout the reorganisation process, whether the turnaround practitioner presiding over the reorganisation process is adequately qualified, whether creditors will support the reorganisation plan and postpone their liquidation order decision, and whether contractual obligations will be honoured during the reorganisation process.

Recommendations for shareholders and managers:

The shareholders and managers of a distressed company can mitigate the concern regarding the protection of capital providers' interests through allowing the turnaround financier to assume a board position and/or allowing the turnaround financier to appoint a qualified turnaround practitioner to guide the company through the reorganisation process. As stated above, the creditor coordination problem can be resolved through pre-packaged bankruptcy or acquisition of unsecured creditors' claims in the distressed debtor by the secured creditors. The shareholders/managers of the distressed company can facilitate this process. Additionally, shareholders/managers of the distressed company could agree to honour pre-distress contracts despite having the ability to do so under Chapter 6. These recommendations are aimed at resolving the mistrust between creditors and shareholders/managers of distressed companies which often results in liquidation.

2) Return considerations

The most pertinent return realisation considerations are the ability for the distressed investor to appoint new management and take an active role in the distressed company, priority ranking of the turnaround finance facility, and the quality of information provided as this may distort valuation of the distressed company.

As stated above, the issue of mistrust between creditors and shareholders/managers of distressed companies is the main cause of bargaining frictions between the parties which often result in creditors opting to liquidate a distressed company and/or a distressed company failing to secure turnaround finance. The abovementioned return considerations as identified in the study are aimed at resolving this mistrust dynamic through the introduction of a third party, the distressed investor.

Recommendations for shareholders and managers:

Shareholders/managers of distressed companies need to facilitate the introduction of a representative of the distressed investor onto the board of directors or, as the case may be, into an active managerial role in the company. A distressed investor is concerned with protecting their value as investing in distressed companies is viewed as high-risk and a specialised field. The distressed investor's experience in acquiring and integrating distressed companies can serve as a valuable asset for the management team during the reorganisation process. The distressed investor may require their turnaround facility to have priority ranking in relation to the pre-reorganisation liabilities of the company. Once Chapter 6 is effective, this will be possible but before the effective date of Chapter 6 (muted to be July 2010) this may not be possible within the confines of the current South African legal framework. The information provided to the distressed investor needs to be verifiable and accurate as this is a concern from a return realisation perspective. The introduction of a distressed investor can resolve the mistrust dynamic but shareholders/managers need to address the abovementioned returns considerations in order to facilitate the introduction of a distressed investor in the company.

7.2.3 Sources of turnaround finance

The study identified three sources of turnaround finance, namely: internal forms of funding, existing financiers, and private equity investors. The risk and return considerations of capital providers detailed above relate to the provision of turnaround finance by existing shareholders and private equity investors. Additional considerations in this regard would be the economic viability of the distressed company as well as the managerial abilities of incumbent management.

Recommendations for shareholders and managers:

In order to secure turnaround finance from external sources (existing financiers and private equity investors), the shareholders/managers of the distressed company need to have been engaged in internal forms of finance by reducing costs and disposing of assets in order to improve the recoverability of the distressed company. Equally, the shareholders/managers need to provide verifiable information as to the economic viability of the company. The assessment of managerial abilities can be resolved through the facilitation by shareholders/managers of the introduction of a representative of the turnaround financier onto the board of directors or into an active managerial role. The recommendations detailed herein are aimed at providing a basis for the resolution of the mistrust dynamic inherent in financial distress.

7.3 Areas for future research

The first area of future research could be the extension of the sample to include all the members of the Turnaround Management Association of Southern Africa ("TMA-SA"). The research instrument could be modified into an online survey with a mixture of open-ended and closed-ended questions. This would facilitate the extension of the sampling frame as the TMA-SA members are nationally spread. The findings of the study can be applied to a case study of an actual turnaround situation to get a sense of which constructs hold true with respect to the factors which influence turnaround finance. It should be borne in mind that the bankruptcy resolution laws in the country are in a transitory period at present and as such the findings of research studies of this kind should yield different results once the business rescue provisions of Chapter 6 are effective.

Another area for future research would be to investigate the mistrust dynamic between creditors and mangers of distressed companies to establish the role this plays in the liquidation decision. The concept could be investigated through a case study of a distressed situation which resulted in liquidation. The relevant stakeholders (judicial manager, liquidator, managers of the distressed company, and the creditor who filed to liquidate the company as well as other creditors) could be interviewed using semi-structured interviews to get a sense of the extent to which the mistrust dynamic played a role in the liquidation decision.

The critical limitation of the study was the limited availability of primary data on reorganised companies. Future studies could be enhanced by the availability of primary and secondary data in this regard. This will facilitate deeper research and empirical data which can be reviewed in relation to findings in other parts of the world.

7.4 Concluding remarks

The findings have indicated that the factors which influence turnaround finance exist across three levels: macro-environmental factors, industry-wide factors, and company-level factors. The key macro-environmental factors identified by the study were political factors, economic factors, and social factors. The identified factors had a direct and indirect influence on turnaround finance.

The legal environment within which turnarounds and corporate reorganisations are performed was identified as an influencing factor particularly in relation to the shortcomings of judicial management as a bankruptcy resolution mechanism. Certain shortcomings with the provisions of business rescue within Chapter 6 of the Companies Act were identified but generally, the new legislation was viewed as a necessary evolution.

The industry-level considerations in relation to turnaround finance were considered from an industry-wide distress perspective as well as from the risk and return considerations of capital providers. The findings related to the effect of industry-wide distress on commercial banks' decision to provide turnaround finance as compared to development finance institutions' and specialist finance companies' decision to provide turnaround finance. Additionally, the key risk and return considerations of capital providers were provided. And lastly, the sources of turnaround finance at a distressed company level were considered and presented.

The provision of turnaround finance to distressed companies represents a means to restore corporate value in economically viable distressed companies and the factors which influence the provision thereof exhibit interrelationship which shareholders and managers of distressed companies need to understand and appreciate in order to successfully secure same.

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9. APPENDICES

APPENDIX 1 – INTERVIEW GUIDE

Research Title: Factors influencing the provision of turnaround finance to financially distressed companies in SA

1. Introduction

1.1 Purpose of interview

The purpose of the interview is to solicit expert opinions from senior executives within the professional fields of law (commercial and corporate), corporate finance, specialist finance, and turnaround management (practitioners and academicicians) who have experience in judicial management, informal creditor workouts, debt restructuring advisory services, corporate reorganizations and turnaround management in an effort to both identify and to get an understanding of the factors which contribute to financially distressed companies in SA being in a position to successfully raise turnaround finance whether in the form of debt or equity capital.

1.2 Interview administration

- Ensure that the respondent consents to the interview being conducted and signs a consent form;

- Seek further consent from the respondent to record the interview for transcription records;
- Discuss purpose of interview;
- Discuss and agree on terms of what will be done with data from the interview; and
- Explain process of data collection and analysis.

2. Interview Guide

The research questions which need to be addressed in the interview are as follows:

(Interview questions are highlighted in Red)

Research Question 1: What are the macro-environmental factors which influence the provision of turnaround finance to distressed companies in South Africa?

- Discuss Macro-environment and attempt to discern which factors influence turnaround activity and turnaround finance
- Discuss macro-economic factors which have an effect on the level of financial distress experienced by companies (i.e. relatively high interest rates, foreign exchange volatility, inflation rates, and slowing economic activity).

- Allow respondent to detail macro-economic factors which in their view play a role in whether a distressed company can raise debt capital to finance their turnaround plan(s) or not. Prompting the respondent's opinion is to be limited to factors referred to above.

Research Question 2: Does the legal framework within which turnarounds take place in South Africa encourage or discourage the provision of turnaround finance to distressed companies?

- Discuss judicial management and business rescue provisions of Chapter 6

Research Question 3: Does industry-wide distress play a role in the provision of turnaround finance?

- Ask the respondents whether they believe industry-wide distress plays a role in the provision of turnaround finance
- Discuss why the respondent believes this is or not the case

Research Question 4: What are the most pertinent risk and return considerations in relation to distressed investment from a capital provider's perspective?

- Discuss risks associated with both funding distressed companies and investing in distressed companies
- Discuss return considerations as relates to funding distressed companies and investing in distressed companies

Research Question 5: How do distressed companies in South Africa finance turnaround plans in the absence of a 'debtor-friendly' bankruptcy code?

- Establish how distressed companies raise turnaround finance
- Determine the sources of the turnaround finance
- Discuss the company attributes which play a role in a distressed company being in a position to secure turnaround finance

3. Closing questions

a) Do you believe there are any other factors which may influence the provision of turnaround finance to a distressed company?

b) Are there any individuals you can refer me to interview in this regard?

4. Post-interview procedure

a) Send e-mail to thank respondent for their time.

b) Establish permission to contact the respondent for clarification and further information sharing should this be required.

c) Make contact with individual the respondent has referred me to.

5. <u>Post-interview notes</u>

a) Detail emerging themes from interview.

b) Review 'depth' of interview from a data collection perspective.

APPENDIX 2 – TRANSCRIPTS OF RESEARCH INTERVIEWS

(***Please note that the partial transcription of the audio recordings of the research interviews with Jan van der Walt and Danile Nyalunga have not been included in this section, however, the actual recordings have been submitted with the research report***)

RESPONDENT NAME	**:**	**Claire Van Zuylen**
MODERATOR	**:**	**Nchaupe Khaole**
TRANSCRIBER	**:**	**Danielle de Villiers**

R I will talk about why judicial management does not work anymore. Judicial management has two factors, legal and economic. I will indicate how these are intended to be addressed by Chapter 6. Then I will indicate why I am concerned why it will not be addressed. I have done some studies on Chapter 11 bankruptcies in the US legislation as well administration under the UK Insolvency Act as I have found that my clients are US and English based. I will talk about judicial management. As there are thousands of liquidation orders every year, there are very few judicial management orders and often even if a company obtains a judicial order it still goes into liquidation afterwards.

Part of the difficulty of liquidation is that it is difficult to get into judicial management, as there is quite a high onus that the applicant needs to show. The applicant needs to show that the company failed due to whatever reason and that a judicial management order could turn it around. So basically the applicant needs to show a business plan in the primary application that shows how a judicial order could help the company turn around. Secondly the other difficulty is the actual application that needs to be made to the high court and the complexity of it and the cost of lawyers (you will probably need an advocate and an attorney). Just the application itself can amount to between R30 000 – R50 000, and then creditors have an opportunity to oppose the application. This route is only available to companies not closed corporations. In reality this only really would be applicable to larger companies who can afford to spend a large amount on legal fees (R200 000). Small companies such as one or two man companies who are already experiencing financial difficulty would find it difficult to find money for legal fees for the judicial application. To summarize the difficulties would be high onus and high cost.

Then the third problem is that judicial management comes with a moratorium against creditor's claims but only once the application has been granted. So a problem arises if a secured creditor hears about the application for judicial management, the creditor could then either make an application for liquidation to obtain the secured assets because there is no moratorium on creditors claims until the judicial application has been granted. Another problem with judicial management is that in South Africa, there is no formal qualification needed to be a judicial manager or liquidator, in practice most of them tend to be accountants and lawyers but you do get some without any qualification. As long as you are on the Master of the High Courts list and in good standing then you could get appointed. The Chief Marketer is looking into this and getting advice from the World Bank. So there is a risk that an unsophisticated person could be appointed to try turn around and run a large or complex business. Another problem is when suppliers have not been paid due to the financial difficulties being experienced by the company. They would cease to supply the company so if it goes into judicial management it is highly likely that it will be difficult to carry on trading due to suppliers freeze out and customers would also prefer to move to a company that is not experiencing trouble. Another problem would be with financing, as most likely all banks would not lend money or extend overdraft to a company who is under judicial management as it would be an unsecured debt. Therefore the banks would have no security over the debt of a company that is already struggling. A judicial manager has to be satisfied that he can bring the company back to solvency and pay all its creditors and bring it out of judicial management. If at any point he doesn't believe he can do that, he must liquidate the company.

M So there is no priority for the creditors?

R No, but there is provision if there are unsecured assets then the creditor could get security over those unsecured assets if the court approves. But the likelihood of a company under judicial management having unsecured assets is basically zero. If they had unsecured assets, the company could have avoided the judicial management by giving them to the bank in an attempt to obtain finance by using the unsecured assets as security to obtain capital.

There is a cultural problem in South Africa around judicial management. As soon as the market hears it, they associate it with winding up. So the suppliers refuse to supply and the customers move on to other companies as opposed to where as in the States bankruptcy is viewed as a minor inconvenience just as the low cost airlines drift in and out of bankruptcy once a year. The above mentioned problems are the main factors affecting judicial management. If you look at Chapter 6 business rescue, you can see the legislature trying to sort out the problems of business rescue. For example: If a company wants to put itself into business rescue then a Board resolution by the board of directors gets lodged with the Company Office. You don't apply to court. There is no high onus to satisfy in court. You just file a resolution and you are in business rescue. That problem of high onus and high cost falls away with the fact that you just pass the resolution.

M Do they need to notify the creditors?

R No, my concern with this is that it could constitute abuse; my issue is that the board that passes the resolution is the same board that put the company into financial difficulties to begin with. Secondly the company could approach the creditor and try to negotiate new terms and threaten that if they are not accepted then they will just go into judicial management. Then the creditor has the right to approach the court and overturn the application if they believe there is an abuse but the problem is that the onus lies with the creditor to prove abuse. Another concern is that we don't know if the company is a candidate for business rescue as there could be issues such as their product is obsolete or the market no longer wants it. Is it a company that can be saved? There is no criteria for judicial management. My view is that if the company cannot even afford R50 000 – R100 000 for an application to court, is it a company that can be saved? Is there enough there to save it? Make a standard application form that the Master scrutinises and grants, if you don't want to go the whole High Court application and lawyer's route. If you look at what the purpose of Chapter 6 is, it is not just a question of the company going into business rescue and it gets nursed back to full health under judicial management. It also embraces the UK system whereby it grants a temporary moratorium and even if it doesn't intend to take the company back to solvency, the company gets sold for more than it would get sold for in liquidation. And again, the UK Enterprise Act which was brought into UK system of administration, the problem here is that it was hugely criticised in the UK as you get companies with devious directors that were getting into financial difficulty. They file a petition, they get into bankruptcy and they say to the bankruptcy administrator: We are offering to buy the business for x and you have 24 hours if you want to take it otherwise we withdraw it'. The administrator has no accounts to go get proper evaluations, the business gets sold out to the new entity created by the same directors who now buy it free of all the debt and they still get paid. What the directors should have done is put the company into liquidation and it could get properly dealt with. But of course, liquidation means going to the court and getting an affidavit and getting an order. So, I believe that business rescue is not just getting the company back to solvency; it's about selling off the business and setting off the creditors. You are giving a company an easy way to liquidation without the checking of balances in the liquidation scenario.

If a company finds itself in financial distress and it doesn't opt to take itself into business rescue, it is liable to send a notice to employees, shareholders, trade unions and creditors and the bank stating that we are financially distressed and for x, y and z reasons, we have not decided to go into business rescue. It is very admirable as it means that third parties that are not normally entitled to financial information of the company are warned. How practical is it in a South African environment, because lets say lots of new businesses are insolvent for at least 5 years, during their R & D phase or while they are building up their market share. Then I am not sure how practical it would be, as you would get the bank panicking every time they get a notice pulling the overdraft facility. There are a lot of companies who might be financially distressed as soon as the payroll goes through on the 25th of the month but by the 3rd of the next month they have reestablished solvency. I think ideologically it is a good idea, but I am not too sure if practically it is a good idea.

M Do the directors of the debtor company have to provide solvency certificates

R No

M If I am a manager of a company and my company is technically insolvent. However for the following reasons….

R There is no need to provide insolvency certificates. The only obligation in Chapter 6 is that if you are financially distressed and you choose not to go into business rescue then you must notify your creditors, employees and trade unions. So, although there are no insolvency certificate requirements, you need to explain why you are not going into business rescue. You have an obligation to make that statement and if not, according to the Companies Act, the directors could be held criminally responsible for that. Once it is in business rescue and the resolution has been adopted by the successor to the company, the moratorium operates immediately. Even if they were not a candidate for business rescue, they quickly filed for a resolution with no external scrutiny and they immediately got a moratorium. Yes, the Act then goes on to say that within seven days, you need to appoint a practitioner. He then has x number of days to tell the creditors that they have x number of days to produce the business plan the creditors must vote on it. A debtor then has the opportunity without any external scrutiny, to bypass the moratorium. Also in South Africa, the board stays in place and the business rescue practitioner is appointed. Under Chapter 11 business rescue and bankruptcies in the States, the existing board stays on. There is no practitioner who is appointed. The board stays on. Only where the creditors can motivate that there has been fraud do they ask the US bankruptcy court to appoint an administrator to be appointed to the company. In the UK for example, the board is given an administrator. Under our judicial management, you have the board and the practitioner. Now what worries me is that to what extent if something goes wrong will the board blame the practitioner and the practitioner blame the board and the creditor loses out. Secondly, will there be a duplication of costs. It is my biggest concern as the company is struggling and is trying to get out of financial difficulty. Thirdly, Chapter 6 states that the practitioner has a duty to the company. Now, the judicial manager has a duty to the creditors because what is best for the company is not necessarily best for the creditors. My biggest problem with business rescue is that as a lawyer, I don't have a problem with instituting a system that has draconian inroads into people's lives. As long as it is a carefully sort out process. For example, with liquidation we all know how to liquidate and have the power to cancel contracts and subpoena people. All of those have survived constitutional challenges. But to get to liquidation, I need to convince a judge that this is a candidate for liquidation. There is a process. Here, companies with business rescue and a practitioner have powers far greater than the liquidator. And yet, look how easy it is to get into business rescue. The board just passes a resolution and then you are in business rescue. There are two sections 132 or 134 provide what the practitioner or liquidator in the company in business rescue have ties on. The first is that there is no power to terminate contracts or to amend it. Normally the big break with turn around specialists is that you should trim your overheads get back into solvency. Now they have taken on board these wonderful qualified corporate finance people and the market has changed, they need to cut the deadwood away. Maybe they didn't have the heart to but a business rescue manager or practitioner will cut that dead wood away. But in a huge trade union incident in the drafting of the business rescue chapter, it specifically provides that the contract of employment may not be affected other than in the ordinary course of the Labour Relations Act. If you are going to retrench people, you have to follow the Labour Relations Act and you have to pay full retrenchment packages. The other problem is that you cannot even unilaterally reduce anybody. You might find that he gave everyone ten percent salary decreases, so you might find that twenty years later, the salaries are no longer market related for that type of work. So that section would tie the practitioner's hands behind his back. The whole point is to avoid job losses but you may need to retrench twenty five percent to save seventy five percent. Or you might need to reduce everyone's package by ten percent and take away the overly generous medical aid and benefits in order to save hundreds of jobs. Although in the Employment Contract of South Africa, in section 132 or 134, I forget which section it is, goes on to provide that leaving aside employment contracts, liquidators have the power to suspend partially or entirely, all or any provision of an employment contract. This is the part where I went down to parliament and made a submission about it as I was so disturbed by it. I don't think that anyone disagrees that South Africa is a country in dire need of direct foreign investment. I often do corporate work and I know that in the US and the UK they often require local attorneys to give opinions before the transaction closes to say that this transaction has not been fiddled with. So that they know that if they do a deal, they can rely on that deal. The old Roman Dutch contract law in South Africa was always very much that a contract is a contract. If you sign it, you must have read it. You always uphold the four walls of a contract. We know that in liquidation, a liquidator can fiddle with contracts but this is in limited situations. Either if the contract is in avoidable disposition, in other words, the assets was sold at less than market value. Then yes that transaction can be set aside. Alternatively, if it is a partially completed contract, the liquidator can refuse to continue acting on the contract but at least you know one way or the other. Either the contract is set aside in full or (Inaudible). Although we are familiar with the fact that in liquidation, contractual rights might not be as firm as they were out of liquidation that only defined areas where your contract can be fiddled with. Here, the practitioner can suspend partially or completely. Take for example that you are a landlord and you own a huge commercial block and your tenant is a huge company and they take up the entire block. They pay you rental and you pay your bond. It is a nice secure investment. The business rescue practitioner turns around and says to you that they are suspending your their obligation to pay rental for six months. There is nothing they can do about it. That to me is too widely framed. It should be more narrowly framed. Technically if the bank advances money against the security sale of a mortgage bond, what is to say that the practitioner will say that I am canceling forever? Could he cancel the security for no apparent reason? I would hope that the court would restrict that. But there it is on the face of it. It is a huge problem.

M *This would in essence have an effect on whether the bank would be in a position to fund a company in distress?*

R No, It would only apply to existing contracts. I am concerned that if you knew as a foreign company investing in one of these PPP's like Paul Rivier which is French. If you knew that the people you were contracting with in South Africa could with no notice to you file for resolution with no scrutiny from the courts, no making a case for it and next thing the business rescue practitioner can turn around and cancel contracts. We have got our own conditions which are in our favour and everyone walks away satisfied. The practitioner can take out all the provisions they don't like. The deal you started with is very different to the deal you end up with. The other concern is that section lifts the power to that supervisor so what happens is you have a fraudulent set of directors, filing for resolution, they know that the company is not really a candidate for business rescue and the practitioner gets appointed seven days later and cancels a whole bunch of contracts, suspends a whole lot of other provisions. The business rescue plan is then put to the creditors and they reject it so that the business rescue has to then fail and fall away. So does that automatically mean that a contract is revived? I don't think so. So you can have people deliberately bringing business rescue, buying themselves a moratorium for three or four months knowing ultimately that they will fail but they have bought themselves three or four months free time. But now other companies are impacted. I am concerned that in the long term you have a company that was never supposed to have survived as its business model was bad, they didn't do enough market research or they expanded too quickly and got too greedy or their product became obsolete. They go into business rescue; there are considerable powers there available for the supervisor that they are provided, whereby other companies are impacted. Other companies that are not successful, they find that contracts have been taken out from under them. They have got a moratorium. They can't get paid, how do they pay. It could be a domino effect. I don't have a problem with investing time and money in saving companies if they are worth saving. Yes, I know it is a harsh market out there and nobody wants to see a company fail but maybe some companies should fail so that it is survival of the fittest. There is a big argument at the moment especially with the IDC and their money that they have got to cop out companies. Should we be investing that money to cop out companies and the minute you stop copping them out, they going to fail again? Or should you plough that money into giving tax breaks and incentives to those companies that are making a success of themselves and are getting bigger and bigger and employing more people and bringing more people into the economic sphere? That is a very emotive argument. In the very first draft of it, when it was still a white paper and it had not yet been presented. When we got hold of the first draft of business rescue, I was very interested to see that there was a provision that said that if you are a pre-business rescue supplier, you are compelled to continue to supply post judicial management provided that you still get paid for it. You can't be expected to do deliver without being paid. There is still a potential that suppliers can turn around and say no, even if you pay us, we are cross that you are behind our backs.

In this economic climate, you might find that some suppliers take the view that the company, which is in business rescue, is as good a customer as any other customer and will continue to supply. There is a potential that post liquidation suppliers could refuse to supply. I think this just applies to financiers but if you are encouraged to do post business rescue then we will give you a priority, only if there is sufficient equity. I don't believe it works if your only asset is an office block currently valued at R10m and when it was built with a bank bond it was valued at R40m. The balance outstanding on the bond is R11million and its only worth R10 million now. I don't think it will be accepted in those circumstances.

M *There needs to be a degree of security and a company in financial distress might not have unsecured assets and to the extent that they do, they have a leap over…*

R Yes, it is a nod to try and neat the problems one has under judicial management. But I am not sure how practical it is. And also you would have to have a whole subculture like the debtors and collectors financing in the States. You have to have a whole new culture of that developing in South Africa. So these are my concerns about the business rescue plan. I think it has huge potential to be abused and I am not sure if that will be considered fully by the Legislature. I think it also depends on who your business rescue practitioner is. The Act says that it must be somebody who is acceptable to an over priced body. We do not have an over priced body for practitioners at the moment. This is an issue as well. If you say that you are a Chartered Accountant or a qualified lawyer, how do you bring in to that HDI? Are you excluding people? Then you get your front-end scenarios and I know a few years ago, a messenger was being appointed as a liquidator because he was an HDI. You have a problem when you want highly qualified people as you might be excluding HDIs. I do not envy the Chief Marketer and the World Bank trying to negotiate that.

M *Can we talk about the body of Administrators and the Turn around Management Association has also made representation to the legislature in terms of the adoption and accreditation of this TMP professional publication*

R I am not aware of the actual status of that. I know that the World Bank is looking at how to set up a body that will have oversight on pre existing bodies. Another one that they would be looking at is AIPSA (the Association of Insolvency Practitioners of South Africa). I imagine a lot of turn around specialists are ex liquidators because a lot of what they do is the same. AIPSA are people who have integrity to join. They are only staff regulatory. You don't have to belong to them. I know the World Bank and Chief Marketer are looking at the existing body and may well look at the turn around practitioners. These specialists come in with lots of flow charts but then charge large amounts to assess where the company is and then they do a few retrenchments, tell the existing staff to keep going and then if the business tanks, they will so too little too late. If the business does well, they take all the glory. The problem with before you are in a business recovery scenario, if you are trying to do one of those informal corporate turnarounds. The problem with that is you may require a moratorium to do it. The big problem with that as I said earlier is that you have very few judicial management orders going through because of the whole court application incentive. If turn around happened on an informal level and you had no moratorium. If you want a moratorium then every single creditor has to agree to this moratorium. It is normally the banks who have to agree to the moratorium. It is the small suppliers who take a knock to their business. So either you need to get the consent of everyone and then the business is vulnerable because as soon as the turn around specialist compiles a power point presentation for the creditors, there is no moratorium in place so they could walk out of that meeting and they will know that the company cannot pay its debt. The big creditors then have to agree that if a small creditor refuses then the big creditors will need to pay off the small ones, increasing their debt but then at least they know that there is no wildcard.

M *Would they do that in situations whereby the increased exposure will be translated into equity in the company?*

R Depending on the nature of the turn around. Obviously, if you were to take out equity, it would be a high risk scenario for the bank or private equity fund. Because if the turn around fails and you are a shareholder, you could end up with nothing. So it is high risk. The other thing that is important to remember is that under the laws of liquidation, if a company is insolvent. Not in a liquidation sense but in a sense that its liabilities exceeded its assets and it gives security to creditors and not to others. It can subsequently go into liquidation. That form of security will be known as a preference. The other risk with informal turn around, prior to liquidation is that if a company says you give us further money and although we have ten other creditors screaming for money, we are going to give you general bond over all of our assets. If the turnaround fails, its because the company was in a great nosedive. They could not pull their nose up. If the finance taken under judicial management is not going to be easy. That is the other problem with informal turn around going on at the moment as nobody is doing judicial management. It is not a given that it will be set aside. I would argue that you are not giving creditor x the security simply because you like creditor x. Creditor x has given you money with which you hope to trade up your difficulties with. You are giving the security for the money, not to prefer them. I have successfully argued in the past that the security given in that scenario is not a preference. It is not a given but one has to flag it as a risk which is another reason why people have to tread very carefully with the post (Inaudible).

M *In terms of avoiding the issues. What are the issues around preferences to particular creditors? Does that mean that structuring has to be different? Let us say, I am a creditor and I am in a position to expand in turnaround in an informal workout. I can only do so if I can get security….*

R That is the argument. It is a new facility. You get existing financiers that extend the finance because they know the customer and then you get the question 'Are they being preferred?' but it is a risk. I would be very careful to ensure that the documents recorded for the new security is not given for the old debt but rather for the new stuff. The other option if you are not going to do the turnaround debt financing, if you are going to take equity as we spoke about earlier. The problem you face there is if the business tanks you will get nothing back. At least with security, the liquidator has a chance of coming out and being a secured creditor.

M *Do you find currently that your clients would have opted for an informal work out?*

R One other problem with informal workouts is that you would have to advice the directors of the board. Especially for a company that is in the reckless trading provision. Are they trading recklessly going into this work out? Reckless trading is what it is. The law is not here to punish bad business decisions or even negligent business decisions. It is there to punish growth negligence. So if the turnaround is entered into and advice is given by practitioners, it is unlikely that the directors will be held personally liable for the debts incurred in that informal turnaround period. But still, it is something that one has to look at and it is another risk that one needs to flag and be comfortable with the degree of risk. If for example this turnaround is clear to any intelligent third party then yes, the directors who allow debt to be incurred during that period will be seen as negligent and will be held personally liable for that debt.

M *Finding that clients would have opted for this in the past are amenable to considering what Chapter 6… (Inaudible)*

R Look, there is a lot of excitement about Chapter 6. For clients that are dodging bullets at the moment and in my view are insolvent, they are looking forward to business rescue with some enthusiasm. It is easy to get into, there is a moratorium, and they can get rid of contracts. The people who are freaking out at the moment for example, the banks, because although it is not yet in effect but if you are giving finance and taking security with a term of more than a year then although the Act will not have retrospective effect during the course of your agreement, suddenly the practitioner will have the right to start fiddling with your contractual rights and security. I am concerned it will reach a point where the banks won't lend you the money. If we need to stimulate entrepreneurialism in this country we need start ups, people who have left jobs in the formal sector and those are the ones that need the bank to take a risk. If banks are risk averse at the best of times, I think when business rescue kicks in, they will be far more risk averse. I know that banks and big financing houses are very worried about business rescue. I am worried that it is going to be another consequence. We turn away FDI and we are also making it very hard for start-ups to seek capital and get start up financing.

M *And equally, companies that do get bank funding post implementation of provisions could seek additional owners whether its interest rates….*

R Yes. There is one clause and I am still trying to get hold of someone to draft the chapter because I don't like speculating. Normally what happens in liquidation and judicial management is that the company goes into liquidation so the banks do a surety shift. There is a section in Chapter 6 that suggests to me that if a company goes into business rescue, the creditor is precluded from going against the creditor or the guarantor. It is either incredibly floppy redundant drafting, which is okay or that is what it means. I am trying to get hold of an actual draft, as I don't want to speculate what was intended there. I had seen some reading before hand that the concern was that the directors had all signed surety and would be reluctant to go into business rescue because they know they will get sued. So if you preclude the surety from being sued then companies will more likely go into business rescue. If you were a bank today, you would take surety from the company but while it is in business rescue and has a moratorium then you cant do that and potentially go against your surety. One of the banks said to me in a jolly-hearted way; 'Okay, we will take the principle debtor as an individual and the company will be the surety'. If the Act is ambiguous, then an amendment will need to be made. An amendment can take up to four years to process. My biggest concern is that section that says that a supervisor can fiddle with contractual rights. What I said when I went down to Cape Town to submit to Parliament 'There should be a difference between contractual obligations and liability. No contractual term of a company should ever be fiddled with. A company's obligations can be suspended but the terms must not be fiddled with. Either you grant a moratorium on the basis that you pay liabilities or on the obligation to perform. I think they intended one of the two but they went too far and three said you could fiddle with all or any contractual terms. There were some people from DTI sitting down there and I actually saw some people nod. I know that with all these foreign investment deals, they want to know that their contractual rights are secured. Three weeks later, the final draft came out and there were a few semantic changes and there was nothing I could do about it, I had tried.

M *Let's hope that there will be an amendment, rather sooner than later*.

R I know that the South African Law Commission is not ecstatic with the draft of Chapter 6. Maybe they will do something. They are busy doing the regulations but government has made it very clear in a circular that they sent out that they are busy drafting the rest and what do you as shareholders want to say. The purpose is not to amend the shortcomings in the chapter. The red hasn't come out yet, they are still working on it. I don't see the Companies Act taking effect till right till the end of 2010. Business rescue cannot offer it because you have to have a practitioner who is qualified in terms of the education requirements.

M *Thank you for your input. It was very valuable. I would appreciate it if at a later point I can drop you an email and I will let you know how the study is going.*

R Definitely, especially with turnaround. It is such an emotive topic whether a company should be turned around or not. Did they have a bad business model or should you use resources to give them tax breaks, incentives to employ people etc.

M *Thanks again.*

RESPONDENT NAME	:	**Jamie Hollins**
MODERATOR	:	**Nchaupe Khaole**
TRANSCRIBERS	:	**Danielle de Villiers and Nchaupe Khaole**

M *There is very little that has been documented. I spoke to my supervisor about doing an exploratory study on turnaround finance in South Africa. There is not a lot of literature on turnaround finance in general. There is a lot on debtor-in-possession finance that they have in the States but in terms of other parts of the world, there is very little on developing economies. It is virtually non-existent and there is nothing in South Africa. As we couldn't get any primary data, the backbone would be to interview people who have advised on transactions whereby the entity requires funding to fund the turnaround plan or alternatively individuals who have experience in helping companies in financial distress and how they were able to secure funding. And hence why we are here. We split it into three, being the macro factors and economic conditions, the legal environment as well in the key specific areas, more the banking side and considerations that will affect the turnaround finance decision and equally at a company level and what characteristics the company would need to exhibit in order. If I could get your views broadly on turnarounds in South Africa, your experiences and difficulties you have encountered.*

R I have had limited experience in turnarounds. There is a good reason for that and there might be a good reason as to why in a South African context, particularly, there's not a lot of documented literature on it. If you look at turnarounds it can be broadly characterised into two groups. The first group is where the company itself is struggling and needs to be turned around either due to bad management or bad capital structure, bad product or bad price. The other category is a category which we are seeing at the moment which is due to the broader economic downturn which results in a whole lot of companies beginning to struggle as a result of the broader economic outlook. Those are a lot more difficult because often they can't be turned around because of the economic conditions and one can look at reducing costs which is the only thing one can do in this sort of market so one can survive the downturn and still be there when the economic conditions pick up again. If you overlay financing on top of that, it can create a very different picture. If it is just the company itself and the economic conditions are doing well and it is just a problem company, it is easy to obtain finance because the macro economic factors and the support you require are very strong. The banks are willing to lend and take risks and all those conditions are in place to allow you to start lending. When there is a broad market downturn, banks tighten the lending restrictions and requirements and as a result companies that are facing difficulties are going to find it difficult to find financing in that period of time. You have to look at it in two categories. Let me talk about the broad market and then we will look at the current financial structure that exists in the business. Then we will approach the current financiers of the business: shareholders, bankers of the business to try and get turnaround finance from them as it is very difficult to approach a new financier in this environment particularly if the company is struggling. Rather approach a financier who understands the company, who has history with the company, who has a track record with the company and who has been with the company for a while and knows what is necessary to get the business through. Such as cutting costs and the ability to get through this and survive this. It is very difficult to get fresh and new financing into businesses when the macro economic climate is struggling the way it is. Having said that, the existing financiers are far more willing to consider comprises, write downs of bad debts, extensions of debt terms, interest rate holidays. These are various mechanisms to help the business through this time. One finds when the business is struggling and not the macro climate, banks take a harder line on extending finance and loans. When a small sample of their books is going bad, they rather accept it and they can write it off. In bad economic times a large portion of their books are going bad and they cannot afford to write it off and move on so they have to help out. I've had limited experience in turn around with financiers because the financiers, the banks themselves are the most well equipped and have to step in and try and help that business in its turnaround strategy. All large commercial banks have got their divisions that specialise in corporate recovery, turnaround, intensive care units or whatever each bank calls them. They each have terminology that they use and have specialists who help them. It is rare for others to be called in as advisors.

M Do you find that in terms of when existing financiers step into the mould; the effort and quality of the underlying business comes into play. Because there are a lot of companies that are struggling due to macro conditions there needs to be a corresponding pledge of additional collateral. Usually businesses that are struggling may not have any additional unsecured assets and this would put them in a position whereby they cannot raise any additional capital.

R You are 100 percent correct. In current market conditions, the bank or financier looking at the asset will make one decision: What security do I have and can I access that security? If they can access that security and you can offer them 100 cents in the Rand, which is probably the first decision they will take. That tends to happen when the company itself is failing but the economy is doing quite well. In that scenario, the corporate shouldn't go speak to its own bankers but rather go speak to new financiers who may be willing to take equity to replace the current financiers. When the macro economic environment is struggling, you are very often protecting the security, which is very difficult for the bank because the underlying security are assets and when the economic conditions are poor, the value of those assets has gone down particularly in a fire-sale situation where the liquidation of those assets is being auctioned. We have a client at the moment who we are assisting in a turnaround situation where there are two businesses, a shopping centre and a lifestyle eco estate. There is quite a lot of debt in the shopping centre and the lifestyle centre has guaranteed debt or signed surety for the debt. The shopping centre is performing badly at the moment and is not able to service its debt due to low occupation rates in the centre and low rentals. The financier is now saying I can call in the security, liquidate the assets, sell off the shopping centre and then approach the lifestyle centre to make good in terms of the surety. They recognise that the shopping centre is worth one hundred million Rand in terms of replacement cost. On auction maybe he can get 30 or 40 million Rand. A trade buyer would probably buy at 40 to 50 million Rand. Even though they had 100 million Rands worth of security in terms of underlying assets in the shopping centre, that security is not worth what they thought it would be. Then they have to look at the lifestyle estate and it sells 1500 crops of land a month and it guarantees cash flow through that. If the financier of the lifestyle estate is now responsible for the short fall of the shopping centre, you can't pay that in one go. You have to rely on the lifestyle estate to continue to sell land. If you auctioned the lifestyle estate and ended up selling 3 or 4 crops of land a month, you would have to drop you price by 70-80 percent. So the security is there, but the value of that security is significantly lower due to the economic conditions. At this point the banks faced with the same scenario two years ago would have auctioned the shopping centre and probably received 70 - 80 million Rand, 20 million Rand shortfall, liquidate the lifestyle estate thereby receiving close to fair value for the individual crops of land. So a very different scenario pans out when the macro environment is poor compared to when it is good. That summarises the difference.

I haven't had any particular experience in a company that is performing badly. In a strong economic environment you need to bring in new management or you need to bring in new products or product pricing. That is typically a specialist field compared to a generalist field. There used to be a group around owned by a guy named Peter Flack. I think it was called FRM advisors and they are turnaround specialists. They have financial backers and those financial backers recognise them as turnaround specialists. So they went into a company that was struggling. They took over the management role and brought finance at the same time. That seems to be a formula that works well when the economy is doing well. It is very difficult to lend money to a management team that have failed in good economic conditions. So generally one looks at replacing the management team when turnaround finance is brought in at the same time.

M **In terms of these specialists who look at distressed investment. Do you find there are a lot of players in the market or do you think FRM and the Gandalf Trust are the few who exist?**

R It does seem to be a specific specialist field. I'm not sure how successful the track records of these companies have been. They have had tremendous success with some high profile players and have been quiet for quite a long time which you can conclude that they have been successful but are just not publicising it. You need people with strong management and operational expertise. It is one thing to go in and fix the balance sheet and another to go in and fix the operations of a company. Corporate financiers and corporate advisors are very strong at looking at companies' financial structures.

M **Is there a lot of work around with the debt restructuring of capital structures that traditionally would finance using equity but owners have come on hard times and then use debt to finance, even though debt has its risk because it's a way to diversify risk?**

R Well, companies that have fallen on hard times and in the South African market particularly among owner managed or small shareholder private companies, the concept of reducing ones risk by bringing in debt is a bit of a misnomer, because South African banks are notorious when lending debt to make sure they get security and surety from all of the equity providers. Very often an equity provider may be putting in R10m of equity and raising R20m but signing personal surety for the debt and very often we advise our clients whether that debt is working in their favour or against them and if they should be replacing the debt with equity. The main reason one should use debt is not to reduce your exposure but to increase your internal rate of return by finding a cheaper source of finance. It is rare for a private company to reduce their exposure through debt.

M **There is a lot of talk currently around Chapter 6 of the new Companies Act which will facilitate this. I don't know if you have come across any literature in this?**

R I have had a very brief update with regards to the new Companies Act and particularly that section. I am capable of commenting on it but am not a specialist. The lawyers that I have spoken to said that it is very complicated. They are not sure about how it will be implemented or if it will be able to achieve the objectives that it was set out to achieve. It seems to be a merger of the content of Chapter 11 coming out of the US and legislation out of the UK.

M **I spoke to a lady who put forward representation before Legislature when it was still a Bill and she mentioned a number of shortcomings of the Bill at that stage. Some of her concerns were addressed but a lot weren't and she doesn't expect much to happen until the regulations are in place and she thinks that will be towards the end of next year. But a problem exists for companies in financial distress that are now in limbo before the regulation comes into place as to whether they need to go under judicial management or business rescue.**

R My understanding of the new Companies Act is that it has been promulgated but not enacted, which means it has no legal effect at this point in time until it is enacted by Parliament and signed off by the President. The problem with the provisions of Chapter 6 is that it doesn't provide the secured creditors with any greater security or support. I understand why there is a need for the legislation as currently when an entity comes into difficulties and is liquidated; the entity ceases to exist thereafter, purely as a result of problems with its capital structure. You should allow the operating entity to continue to succeed and exist to protect jobs and competition in the market place and allow the capital structure to fail and then be replaced. The problem is the complicated liquidation process that we have and at the end of that process would be the end of that company. I think the legislation has good intentions but will only have an effect after a number of years and amendments.

M **I think we are a long way from having the legislation that we need or something similar to Chapter 11. In terms of firm level**

characteristics, you spoke about companies who have fallen on hard times due to bad macro economic conditions and said that it would be easier for a company to obtain finance in this situation.

R Not easier to raise finance but definitely easier to enter negotiations with the current financiers whereby you could extend the terms of the repayments or get an interest rate holiday. It is difficult to replace finance with new finance especially if the company is struggling to service its current debt. Banks are willing to talk as they cannot take a hard line as they know due to the current conditions that the value of the surety has decreased and weakened.

M Would they still entertain discussions if it was an industry wide condition such as the textile industry?

R They would if the there were specific economic factors that indicate that the industry would improve over time. The problem with the textile industry was that we could not compete with Asia unless government imposed import quotas and tariffs which again (be in contravention of WTO provisions). So in this case the bank would probably not be that willing to trade out of the scenario as there doesn't appear to be light at the end of the tunnel. As soon as there is light at the end of the tunnel the banks would then be more approachable. You would still need a demonstrable plan to show to the bank. You must approach them and show them what you have done and say we have retrenched this number of employees and cut costs by a certain amount, show them the new budget and forecast which shows a turnaround and thereafter economic activity picking up and then back to normal. You need to bring the bank in and be open with them so that they can understand the problems then you could have a more receptive bank.

M **I think we have covered the 3 dimensions we wanted to cover. The final result of the project will be a high level distillation of what we've found and then leave to future researchers the opportunity to put these to the test. But so far it has been good, especially from the association.**

R I didn't realise that there was an association.

M **Yes, the gentleman who heads it up is Jan van der Walt. He has been doing turnarounds for 15 years. He said he is surprised by the amount of interest in turnarounds by MBA students. He says he gets approached by students every week who need assistance with their theses.**

R It is very topical and anyone can understand why as we are facing the worst economic recession in living memory. So turnarounds of businesses are a very common thing.

M **Thank you very much for your time, I may need to contact you in a couple of weeks for clarification purposes.**

RESPONDENT NAME	**:**	**Michael Judin**
MODERATOR	**:**	**Nchaupe Khaole**
TRANSCRIBERS	**:**	**Danielle de Villiers**

M **This study is about turnaround finance. I am looking at turnaround finance from a South African perspective. From a literature point of view there is a lot of literature on how companies are able to access finance in the US, however in SA due to the negative view on judicial management and the creditors having superior rights, it has been very difficult for South African companies to obtain turnaround finance. We are looking at how to obtain finance for companies in distress and want to know if you have had experience with any of your clients in a similar position and your opinion on how to turn it around.**

R If you are talking about companies under judicial management going to get finance, it is very different for a company which is financial distress to get finance and there has been no court intervention. So if we can separate the two. Lets deal with the second one first. If there is an order of judicial management, the company power has been taken away because the court has appointed a judicial manager. If a judicial manager is able to demonstrate to an institution that with the intervention of judicial management they can pay debts in the ordinary course, then the institution may or may not advance to funds. But this is highly unlikely as the judicial manger puts himself at risk by doing that. The reason for business rescue is that judicial management fails dismally in South Africa. There are very few instances of judicial management being successful.

Most judicial management in South Africa will end in liquidation. There are one or two examples. I know there are one or two successful companies who at one time were under judicial management. In my opinion I would say it is impossible for a company under judicial management to get low finance. As far as a financially distressed company is concerned where there is no court intervention where the accounts of the company reflect financial distress in a South African environment, it is almost impossible to get funding because banks all use the same model. Unless that same model guarantees them that they are going to be repaid, they just wont lend.

M This function of not having requisite collateral, should the bank monitor a company in terms of financial distress on the basis of operational risk or ability?

R I think it is a very good question and I think it is a combination of both, particularly because of the global financial crisis. There is no point talking about when things get better. Things are not going to get better. This is the norm. If it gets better that is great but we can't sit here and say when things get better. There is such an aversion to risk. Because the banks all work off the same model and there is this aversion to risk, it is going to be almost impossible to obtain those funds. The second instance is also very relevant. In South Africa, a bank will use intensive care for a company that already owes them a lot of money and they will nurse it back to health. Not because they care about the company but because the person there who authorised the money is concerned about his/her position and they want to make sure that the bank does not make a loss. South African debtors are very unforgiving. There is a culture of putting a team together and giving money to a company that is in trouble and nursing them back to health. South African banks do not do that. If you go to a South African bank and ask them for money for a company that is in financial distress and ask them to dedicate a team towards that company to work together with management, they won't do that. South African banks have models that move with people from bank to bank (from Standard bank to Nedbank) and these people have the same mindset. They want the business plan, the want the accounts and the security documents before they give you any money whatsoever. It is very difficult, especially now to get any form of finance. That is why the story of Cyril Ramaphosa is so true. Because he tells the story of how when he started Shanduka, Wesbank refused him finance. They took the model and asked for security and he said no. So he went to Steven Kossef at Investec. He had just won a lifetime achiever award and said to Cyril 'Don't show me your business plans because I do not lend on business plans. Talk to me, I lend to people.' Cyril said to him, 'I have no security, no accounts, no business plan'. He then gave Cyril ten million Rand to start Shanduka for a 25 percent share in his company. He said to Cyril I like you and that is why he invested. That is why he received the lifetime achiever award because that is what he does.

We don't have the culture in this country of angels who will take the risk for you. There are one or two venture capital funds that will take a risk for you but it is very difficult to find that money in South Africa. It was difficult before the global financial crisis and very difficult now. It is extremely difficult in this country if you have a good idea to get going.

M **Did you find that the chief elements to you considering finance would be firstly economic viability, so that you not throwing good money after bad and that it is just a wobble due to the broader economic environment? In this instance have you found creditors to be accommodating in your experience?**

R Very rarely are you able to work it out and the only ones which I have seen work are when the creditors have been approached in the debtors.

But when you put a group of creditors together, there will always be one creditor who will be vocal and that creditor will stir up the others. The other reason why they rarely work and I'm sorry to say that the creditors without their lawyers might do it but there is always going to be one lawyer who will be the financial benefit for himself by liquidating the company. Doing a deal with the company is much less appealing to the lawyer than liquidating. I'm sorry to say it but there will always be one lawyer with client who can be influenced and will go across the company into liquidation. So you will always find informal compromises with the creditors are almost non existent. But you will always find one creditor who will result in the company going into liquidation. I think we made a very important point that there are few resources within the bank to be able to monitor it. The reality is that a lot of the people who had skill to do it in the bank have left the country. They are doing it in Australia, New Zealand and the US where they are working. Many of our clients tell us the people that they deal with in Australia or Canada; three quarters of the team are all South African. They are young very skilled, very smart and they have all left. Not because they didn't like South Africa but because of the crime growth. They were easy pickings for the banks in Australia, Canada and New Zealand. Three quarters of the lawyers and accountants are South Africans. The skilled have left.

M Do you think that the provisions of this new chapter will play a role in order to fuel greater turnaround?

R Obviously its early days for business rescue. I don't know what regulations have been passed. I don't know how they are going to find a way to stop the abuse of the system that South Africans always do. If you look at close corporations introduced for the purpose of small companies. Big companies abuse systems by using small corporations to avoid auditing. South Africans will always find a way of abusing systems. It is very early days to comment on business rescue but the theory on business rescue is good, because judicial management has failed in South Africa. There was no halfway house. Now there, is by providing a mechanism where a good company is in distress and can have an organised and automatic way to be nursed back to health so that jobs can be preserved and companies can continue. In the United States, their equivalent of Chapter 11 works very well. Long periods of Chapter 11 have come out successfully. Generally business rescue serves its purpose. If properly applied, it allows the company in distress to catch its breath again, be put in intensive care and be nursed back to health, come out on the other side and be able to trade again. In theory, it is a relatively difficult concept to understand. If it could work practically, it would be very important as you have an all or nothing situation where you have a very good company where the creditors of banks are not willing to assist and the company has to go into liquidation. Business rescue properly applies when you have a situation where creditors of a bank are not going to be able to apply for the liquidation. The company is going to have the chance to catch its breath and if the practitioners deal with it properly and the courts perform in a positive way then in theory business rescue should work. Because hundreds of thousands of good companies run into that situation where they have one unsympathetic creditor or one unsympathetic bank and the whole house of cards fall, whereas business rescue prevents that. If you meet the requirements for business rescue then you are protected from that creditor. That is why I believe that in principle business rescue is excellent. I just hope that is practice it is not going to be abused. But whether it is abused or not it is still going to be there in the book.

M What steps should be taken to go in the right direction?

R No steps for this. Some of the biggest companies in the world, often not due to their doing, have this ability to do it without their creditors. That is why I said to you earlier about putting all the creditors together in one room where you have one lawyer or one creditor that can destroy a company. I have liquidated companies because there has been one creditor or one difficult person in a bank. Jobs have been lost and lives have been destroyed. Clearly, business rescue is wonderful as it prevents that from happening. I think it is very important that in South Africa there is business rescue. Any company in South Africa can come into misfortune and need it. At the end of the day, it is at the creditors advantage because if the company is rescued successfully, they don't take a knock. You are going to recover everything. And instead of your life being determined by one creditor, one human at the bank or one lawyer, I think the government has done well by using business rescue. Is there anything specific that you haven't asked?

M **Perhaps let us talk about company level factors, I have got a lot to work with from our discussion. What kind of companies enjoys secure and informal compromises? Is there anything general or generic about companies that are able to secure that type of finance?**

R Very good question. I have found that because South African banking seems to be very conservative and also because I think that a lot of the young black bankers are coming into the banking system and yes they have the education but there isn't always an entrepreneurial background. So now there are a lot of young people armed with a degree and going into banking and many of them don't have an entrepreneurial flair. The ones with entrepreneurial flair go out to a company and raise a fortune. There are hundreds of success stories where black entrepreneurs have helped companies grow. A lot of them in finance don't have an entrepreneurial flair. They didn't grow up in a home where their father and uncle made a business because of the ugliness of the system. Now they come into the bank, trained in banking and they tend to be very conservative coupled with the fact that many of their wives are older and come from a conservative and solid background. To answer you question directly, but I am generalising about one company or not. I think I am painting a picture. If it is a property company, God is not going to make any more land so property is always going to have a value. You have got a better chance if you go to the bank and you are a property group. You have a better chance if it is a house in Houghton that has value rather than you try explain to a 60-year-old banker that you have a new software application. It's more difficult if it's a something that you cannot touch.

M So any company with tangible assets?

R It is a mindset of the bank of 'what can I feel'. We haven't yet got to the stage where there is a smart entrepreneur who works at the bank and can work through and feel your idea with you and pass on a motivation to creditors. We don't have that in this country. Angels are few and far between. A lot of angels have been badly burnt and have become very conservative. It is not an easy time globally and in South Africa to raise capital. It is a very difficult time.

M I suppose that's why a lot of (Inaudible)

R Correct. They are really innovative people. They have lots of potential. Many of them starve during the recession. It is not just our banks. In Britain, Gordon Brown has protected them. They belong to us. We are the shareholders. Instead of paying bonuses, take that money and go lend that money to a small business and get them going. They have exactly the same problem in Europe as we have here. The banks in Europe don't want to lend. We are lucky as our banks are properly regulated through people like Tito Mboweni and Trevor Manuel. Because of that calibre, our banks have survived. Tito and Trevor were smart people.

To conclude, I think the place you are in is very relevant and I think somebody like yourself to impact on the market is very important for South Africa to become a great trading market and we can. There has got to be some form of innovative way of financing entrepreneurs and letting them fly. Johan Rupert made a fortune in business and he went to back Obama in the elections and he was part of that group that helped Obama to run and put him into the White House. He made a fortune in technology. He had a calling for the Western Cape to become a Silicon Valley. The Ambassador will work with Rupert to drive that. He said that he thought that the black and white kids coming through now are really smart and that they very innovative. You have third generation smart, young black kids and their wives and all of a sudden you have a huge pool. Johan Rupert believes we can create a Silicon Valley in the Western Cape because of the young people. The nightlife, the clubs, the views and the city of the Western Cape, all of that is for young people. Cape Town is for young people. He believes in attracting young people through the clubs, restaurants and the lifestyle. He said that that was exactly what attracted them to Silicon Valley. He said that he believes that we can create a Silicon Valley, that we have a pool of young males and females of all colours. People will immigrate to the Western Cape. When the Ambassador heard this he wanted to work together with Rupert and use all the technology from the States. There is going to be a huge focus on turning the Western Cape into Silicon Valley. If they do, it will attract the angels because angels go to where the innovation is because they want to be the first.

M **That concentration of innovative people coming up with innovations will attract angel investors.**

R They have a huge pool of smart young people and the pool is getting bigger. Young people love the life of the Western Cape and that will attract them to live there. I think we will see Rupert turn the Western Cape into Silicon Valley as there are quite a few powerful people in Stellenbosch as well. There is also a huge amount of money there. Now with the Ambassador throwing his weight behind it. He was one of the groups that helped put Obama in power and was asked by Obama what would be your one request in this world and he said that he wants to be the Ambassador for South Africa. In conclusion, there is a new group of young people, thinking differently who are innovative, smart, of all colours and genders and I think they will drive a more entrepreneurial South Africa and drive the bank to create this environment for entrepreneurs. I think we are in a conservative, apartheid type era. I think we are going to come out of the economic crisis. We just need to understand that companies need help to become successful and if banks can be come innovative to help these companies and not just tick off things on their models then South Africa can become a great trading nation.

M You have been very helpful and given me a lot to work with. Thank you very much for your time.

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APPENDIX 3 – OUTCOME OF RESEARCH INTERVIEW ANALYSIS

Research interview analysis

Respondent: **Claire van Zuylen**
Date: **20-Oct-09**

1. Macro-environmental factors

Positive factors:
Job loss aversion (political)
HDSA representation in turnaround industry (political)

Negative factors:

No culture of business rescue (social)	Saving companies which aren't worth saving (political)
Judicial management = liquidation (legal)	Contract alteration provisions of Chapter 6 (legal)
Criminal liability of reckless trading directors (legal)	Preferential treatment of creditors (legal)
Chapter 6 is too 'debtor friendly' (legal)	Macro-economic conditions (economic)
Impact of Chapter 6 on FDI (economic)	Job loss aversion (social)
Cost of judicial management (legal)	
Universal qualification for judicial managers (legal)	

2. Industry factors

Positive factors:
Debt-to-equity swaps (returns)
Super-priority of post-commencement finance (returns)

Negative factors:
Fiduciary duty of judicial manager (risk)

Small creditor dynamic (risk)
Universal qualification for judicial managers (risk)
Bodies of oversight (risk)

3. Company-level factors

Positive factors:
Cost reduction (internal funding)
Asset sales (internal funding)
Unencumbered assets (bank finance)
Moratorium on capital and interest repayments (bank funding)

Negative factors:
Cashflow constraints (iro judicial management procedure)

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Research interview analysis

Respondent: Jamie Hollins
Date: 22-Oct-09

1. Macro-environmental factors

Positive factors:
Macro-economic conditions: lower interest rates, GDP growth (economic)

Job loss aversion (political)

Negative factors:
Macro-economic conditions (economic)
Quality of security: assets (economic)
New capital injection (economic)
Secured creditors interests (legal)

2. Industry factors

Positive factors:

Existing financiers (returns)	Quality of management (returns)
Specialised field: banking divisions (returns)	Monitoring requirements (returns)
Specialist funds with financial backing (returns)	Ability to appoint new management (returns)
Consideration of industry prospects	

Negative factors:

Macro-economic conditions: lending (risk)	Job loss aversion (social)
Ability to appoint new management (risk)	

3. Company-level factors

Positive factors:

Cost reduction (internal funding)	Replacement value/market value
Compromises (bank funding)	Soundness of business model
Extension of debt term (bank funding)	Balance sheet restructuring (existing shareholders)
Interest rate holidays (bank funding)	
Specialists with financial backing (external finance)	
Unencumbered assets (bank finance)	
Management quality	

Negative factors:
Advisory fees (affordability)

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Research interview analysis

Respondent: Jan van der Walt
Date: 26-Oct-09

1. Macro-environmental factors

Positive factors:
Long-term economic viability (economic)
Entrepreneurship (economic)

Certainty of process (legal)
Macro-economic conditions (economic)

Negative factors:
No "hire and fire" culture (social)
Stigma of bankruptcy (social)

Macro-economic conditions (economic)
Job loss aversion (social)

2. Industry factors

Positive factors:

Governance of turnaround industry (returns)	Ability to appoint new management (returns)
Pre-packaged bankruptcies (returns)	
Certainty of process (returns)	
Specialist skills required (returns)	
Universal qualifications (returns)	
Existing financiers (bank finance)	

Negative factors:
Universal qualification for judicial managers (risk)
Capital constraints (risk)
Asset quality (risk)
Institutional risk tolerance (risk)
Time is of the essence (risk)

3. Company-level factors

Positive factors:
Economic viability (bank finance)
Moratorium on capital and interest repayments (bank funding)
Cost reduction (internal funding)

Research interview analysis

Respondent:	**Danile Nyalunga**
Date:	**27-Oct-09**

1. Macro-environmental factors

Positive factors:	
Job loss aversion (political)	
Negative factors:	Job loss aversion (social)
Credit shortage (economic)	
Exchange rate volatility (economic)	
Higher input costs (economic)	
Macro-economic conditions (economic)	

2. Industry factors

Positive factors:	
liability exposure = action (returns)	Ability to appoint new management (returns)
Super-priority status (returns)	Debt-to-equity swaps (returns)
Priority sector: DFI perspective (returns)	
Specialist skills (returns)	
Negative factors:	
Stakeholder cooperation (risk)	
Formalisation of the turnaround industry (risk)	
Valuation concerns (risk)	

3. Company-level factors

Positive factors:	
Existing financiers (bank finance)	Ability to appoint new management
Management quality	Debt-to-equity swaps (bank finance)
Economic viability (bank finance)	Balance sheet restructuring (existing shareholders)
Working capital facilities	Moratorium on capital and interest repayments (bank funding)
Expansion capital	
Soundness of business model	

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Research interview analysis

Respondent:	**Michael Judin**
Date:	**28-Oct-09**

1. Macro-environmental factors

Positive factors:
Job loss aversion (political)

Negative factors:
Macro-economic conditions (economic)
No culture of angel investing (social)
Judicial management failure (legal)

2. Industry factors

Positive factors:
Existence of risk capital (returns)
liability exposure = action (returns)

Negative factors:

Risk aversion (risks)	Job loss aversion (social)
Co-ordination of creditors (risk)	
Legal advisors vested interest (risk)	
Information asymmetry amongst creditors (risk)	
Small creditor dynamic (risk)	

3. Company-level factors

Positive factors:
Suretyships (bank finance)
Quality of assets (bank finance)
Write-downs (bank finance)
Moratorium on capital and interest repayments (bank funding)

Negative factors: