



## **The status of post-commencement finance for business rescue in South Africa**

Wanya du Preez  
Student No: 11357012

A research project submitted to the Gordon Institute of Business Science, University of Pretoria, in partial fulfilment of the requirements for the degree of Masters of Business Administration.

7 November 2012



<b>MUST BE COMPLETED BY STUDENT:</b>		
1.	Surname: Wanya du Preez	Initials: W                      Title: Mrs
2.	Student number: 11357012	Year completed: 2012
E-mail address: wanyalabuschagne@gmail.com		
Contact numbers: Tel. +27 11 209 6126                      Cell. +27 83 272 0892		
3.	Degree: MBA	Department: GIBS
Supervisor: Professor Marius Pretorius		
4.	<b>Confidentiality</b>  Please select the relevant option <input type="checkbox"/> No access for a period of two years Specify reasons for consideration   <input type="checkbox"/> No access under any circumstance for an undetermined period. A letter of permission from the Vice- principal: Research and Postgraduate Studies is attached.	
5.	Have you submitted an electronic copy of you research report to the Information Centre? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	
6.	A copy of your research report will be uploaded to UPetd Can the Information Centre add your email address to the UPetd web site? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	
<b>Copyright declaration</b>  I hereby certify that, where appropriate, I have obtained and attached hereto a written permission statement from the owner(s) of each third-party copyrighted matter to be included in my research report ("the work"), allowing distribution as specified below. I certify that the version of the work I submitted is the same as that, which was approved by my examiners and that all the changes to the document, as requested by the examiners, have been included. I understand that all rights with regard to intellectual property in the work vest in the University who has the right to reproduce, distribute and/or publish the work in any manner it may deem fit.  I agree that, a hardcopy of the abovementioned work be placed in the Gordon Institute of Business Science Information Centre and worldwide electronic access be given to the copy on UPetd.		
SIGNATURE: <u>                    Wanya du Preez                    </u>		DATE: <u>                    07. 11. 2012                    </u>

## ABSTRACT

With the onset of globalisation and markets being exposed to the effects of global recessions and economic downturns, the fundamental principles on which business operates have changed substantially. Some businesses have thrived in this new context, whilst others have struggled to remain competitive as is evident by the increasing trend of corporate failures and the considerable increase in liquidations. As a result the concept of corporate renewal and business rescue has become an integral element of the strategy of organisations, particularly those that are financially distressed.

South Africa responded through the introduction of the new South African Companies Act 71 of 2008, which came into effect in May 2011 and contained a new chapter called Chapter 6: Business rescue and Compromise with Creditors. However one of the critical components of the success of the business rescue, which has been largely unsuccessful to date, involves securing turnaround finance (post-commencement finance) to restore the company's financial health.

The aim of this study was to find substantive evidence that the presence of post-commencement finance in South African companies does not exist, as opposed to the findings of international research, as well as the exploration and confirmation of factors that result in the successful raising of post-commencement financing.

To this end, qualitative research with an exploratory design was conducted. Eighteen leading South African business rescue experts were interviewed to uncover their unique insights regarding this dilemma. The rich data that was unearthed was analysed using content and narrative analysis against the propositions derived from the literature.

The empirical findings confirmed that the current level of PCF in South Africa is non-existent due to various reasons. A host of critical success factors and reasons for disinterest were identified which formed the basis of a framework informing the best practice guidelines when raising PCF. Some of these include many of unintended consequences of the newness of the Act, business rescue processes being left too late, the poor financial state of the business that eventually files for rescue and the significant impact on the outcome by some of the key players (e.g. the financiers and

business rescue practitioners). These guidelines will solve the dilemma under review by benchmarking them to international best practice.

Several important areas for future research emerged, alongside the recommendations of insights gained outlined for the various stakeholders.

## **KEYWORDS**

Business rescue, post-commencement finance, corporate renewal, financial distress, distressed lending, Chapter 6.

## 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.

Student Name: Wanya Du Preez

Signature: 

Date: 7 November 2012

## ACKNOWLEDGEMENTS

I wish to express my gratitude to the following people for their support and assistance in completing this research project. Without their help it would not have been possible.

To my **research supervisor** – Prof. Marius Pretorius: Aside from your valued input, thank you for your guidance, trust, encouragement and the freedom you provided me in undertaking this research. Thank you for being as passionate and enthusiastic about this topic as I was; sharing your brilliant mind and being so generous with your time and patience. It was a privilege to work with and learn from you.

**To my amazing family and friends:** My deepest appreciation for all your love, patience, friendship, support and encouragement throughout my MBA. Your support and prayers have given me the courage to believe in myself.

To my **fabulous MBA “study-buddies”**: Natalie, Jan-Adriaan, Omri, Stuart, Dumi, Dwain, Andre, Chris, Edwin. Thank you for all the long amusing hours of studying, great summaries, snacks from Lorenzo’s and many laughs. You kept me sane and were the best sounding boards I could have ever asked for. Your friendship has been invaluable!

**To all the people interviewed:** Thank you for your generosity in sharing your stories and experiences and thereby allowing me to tease out your profound insights. Without your willingness to participate in this research, it would not have been possible.

To my **editor** – Claire Pienaar and **transcriber** – Laura Bezuidenhout: Thank you for your time, effort and energy that was invested into shaping this piece of work.

To Alex, Geoff, Ursula, my colleagues and the leadership team at **Deloitte**: Thank you for your many forms of support and encouragement during this MBA journey. Without you, this literally would have never been possible!

And to the **Lord God**: for showing me the way, the truth and the light. You are my strength, today and always.

## DEDICATION

To my **soul mate husband** - Nick: For loving and supporting me without end for the past two years and for being my best friend and confidante throughout this journey and in life. For all the unselfish and unconditional things you have done to support me physically, emotionally, mentally and spiritually. For the devotion, commitment and patience you have displayed far beyond what was expected. There are not enough words to describe my gratitude.

Whatever I may have achieved, is in truth your accomplishment.

I pray that one day you and our family will share in the long term fruits of this accomplishment. Thank you again...

# TABLE OF CONTENTS

<b>ABSTRACT .....</b>	<b>I</b>
<b>KEYWORDS .....</b>	<b>II</b>
<b>DECLARATION .....</b>	<b>III</b>
<b>ACKNOWLEDGEMENTS .....</b>	<b>IV</b>
<b>DEDICATION .....</b>	<b>V</b>
<b>LIST OF TABLES .....</b>	<b>XII</b>
<b>LIST OF FIGURES.....</b>	<b>XIII</b>
<b>CHAPTER 1 INTRODUCTION TO THE RESEARCH PROBLEM.....</b>	<b>1</b>
1.1 RESEARCH TITLE.....	1
1.2 RESEARCH PROBLEM.....	1
1.2.1 Declining Trading Conditions.....	1
1.2.2 New rescue legislation.....	2
1.2.3 Successes and failures of business rescue cases in South Africa .....	4
1.2.4 The need for turnaround finance .....	6
1.2.5 Closing .....	7
1.3 RESEARCH AIM.....	8
1.4 RESEARCH OBJECTIVES.....	8
1.5 RESEARCH SCOPE.....	9
<b>CHAPTER 2 LITERATURE REVIEW .....</b>	<b>10</b>
2.1 INTRODUCTION TO POST-COMMENCEMENT FINANCE .....	10
2.2 DEFINITIONS AND CONCEPTS IN BUSINESS RESCUE.....	11
2.2.1 Business Decline and Failure .....	11
2.2.2 Financially Distressed.....	12
2.2.3 Business rescue .....	12
2.2.4 Post-commencement financing .....	13
2.2.5 Turnaround.....	15
2.3 OVERVIEW OF THE LIFE CYCLE OF A BUSINESS IN DISTRESS.....	15
2.4 RESCUE FINANCING: STAGES, IMPORTANCE AND BENEFITS .....	18
2.4.1 Stages of rescue finance .....	18
2.4.2 The options a company in distress faces.....	19
2.4.3 Importance of rescue finance .....	20
2.4.4 Benefits to the lenders/financiers.....	20
2.5 THE INTERNATIONAL PERSPECTIVE ON PCF .....	21
2.5.1 World Bank.....	21
2.5.2 UNCITRAL .....	21
2.5.3 United States of America.....	25
2.5.4 United Kingdom.....	27
2.5.5 Canada.....	29

2.5.6	Australia .....	32
2.5.7	Conclusion.....	33
2.6	THE STATUS QUO ON PCF IN SOUTH AFRICA .....	34
2.6.1	Introduction.....	34
2.6.2	Background and history.....	34
2.6.3	Current context for Business rescue Financing in SA.....	35
2.7	PREREQUISITES FOR SUCCESSFUL PCF .....	36
2.8	EXPLORING THE FINANCING LANDSCAPE AND MIND-SET OF FINANCIERS .....	38
2.8.1	Trade Creditors.....	39
2.8.2	Commercial Banks .....	39
2.8.3	Private Market Lenders / Finance Companies.....	40
2.8.4	Private Equity Firms .....	41
2.8.5	Distressed Debt Financiers .....	42
2.9	CONCLUSION.....	43
	<b>CHAPTER 3 RESEARCH PROPOSITIONS .....</b>	<b>45</b>
	<b>CHAPTER 4 RESEARCH METHODOLOGY &amp; DESIGN .....</b>	<b>46</b>
4.1	INTRODUCTION .....	46
4.2	RESEARCH DESIGN.....	47
4.2.1	Research approach .....	47
4.2.2	Research Process .....	50
4.2.3	Expert interviews as a research strategy.....	50
4.2.4	Research setting and background.....	51
4.3	UNIT OF ANALYSIS .....	51
4.4	POPULATION .....	51
4.5	SAMPLING METHOD AND SIZE.....	52
4.5.1	Sampling technique .....	52
4.5.2	Criteria for Selection of Respondents from the Population .....	53
4.5.3	Sample size .....	54
4.6	DATA COLLECTION PROCESS .....	54
4.6.1	Overview of the process .....	54
4.6.2	Interview guide design.....	56
4.6.3	Data Collection .....	56
4.7	DATA MANAGEMENT .....	58
4.8	DATA ANALYSIS.....	58
4.9	DATA VALIDITY & RELIABILITY .....	59
4.10	RESEARCH LIMITATIONS.....	60
4.11	CONFIDENTIALITY AND ANONYMITY .....	62
4.12	CONCLUSION.....	62
	<b>CHAPTER 5 RESEARCH RESULTS.....</b>	<b>63</b>
5.1	INTRODUCTION .....	63
5.2	DESCRIPTION OF SAMPLE .....	63
5.3	DATA ANALYSIS.....	64

5.4	RESULTS: RESEARCH PROPOSITION ONE - INTERNATIONALLY THERE ARE CLEAR PRESCRIPTIVES FOR POST-COMMENCEMENT FINANCE.....	65
5.4.1	Introduction and Overall Results.....	65
5.4.2	Australia .....	66
5.4.3	Canada.....	68
5.4.4	United Kingdom.....	68
5.4.5	United States of America.....	70
5.4.6	Conclusion to Research Proposition One.....	72
5.5	RESULTS: RESEARCH PROPOSITION TWO - THE EXTENT OF POST-COMMENCEMENT FINANCE FOR BUSINESS RESCUE IN SOUTH AFRICA IS NON-EXISTENT .....	76
5.5.1	Introduction and Overall Results.....	76
5.5.2	Extent of PCF in South Africa.....	79
5.5.3	Nature of PCF in South Africa .....	82
5.5.4	Conclusion to Research Proposition Two.....	89
5.6	RESULTS: RESEARCH PROPOSITION THREE - POST-COMMENCEMENT FINANCE HAS CLEAR PHASES.....	90
5.6.1	Introduction and Overall Results.....	90
5.6.2	Phase 1 - Critical and Emergency Funding .....	91
5.6.3	Phase 2 - Pre-Plan Funding .....	92
5.6.4	Phase 3 - Post Plan Exit Funding .....	93
5.6.5	Conclusion to Research Proposition Three .....	93
5.7	RESULTS: RESEARCH PROPOSITION FOUR - PREREQUISITES FOR SUCCESSFUL POST-COMMENCEMENT FINANCE CAN BE IDENTIFIED .....	94
5.7.1	Introduction and Overall Results.....	94
5.7.2	The availability of security .....	95
5.7.3	The impact of the profile and actions of the Business rescue practitioner .....	96
5.7.4	Financiers require a sustainable plan based on a viable business .....	97
5.7.5	Distressed business should involve and engage Financiers upfront prior to filing for business rescue .....	98
5.7.6	Filing for business rescue by distressed businesses to take place earlier.....	100
5.7.7	Relationship of financier with management and the BRP: Trust, Openness and Transparency .....	101
5.7.8	Existence of another financial backer / potential buyer.....	101
5.7.9	Other prerequisites for success .....	102
5.7.10	Conclusion to Research Proposition Four .....	103
5.8	RESULTS: RESEARCH PROPOSITION FIVE - THE REASONS FOR LENDERS' DISINTEREST IN POST-COMMENCEMENT FINANCE ARE CLEAR .....	104
5.8.1	Introduction and Overall Results.....	104
5.8.2	The impact of the profile and actions of the Business rescue practitioner .....	106
5.8.3	Distressed business should involve and engage Financiers upfront prior to filing for business rescue .....	108
5.8.4	Business rescue filing by distressed businesses for wrong purpose and too late .....	109
5.8.5	The availability of security .....	111
5.8.6	State of the relationship of financier with management and the BRP .....	111

5.8.7	Financiers do not have comfort in the rescue plan based on a viable business .....	111
5.8.8	Financier risks losing money .....	112
5.8.9	Business rescue culture and perceptions of business rescue in South Africa .....	114
5.8.10	Concerns and uncertainty regarding the priority ranking of PCF .....	116
5.8.11	Banks are conservative and risk averse due to regulations such as Basel .....	117
5.8.12	Lack of cooperation by banks during business rescue proceedings .....	119
5.8.13	Other reasons for the disinterest of financiers .....	120
5.8.14	Reasons for lack of PCF by distressed lenders .....	123
5.8.15	Conclusion to Research Proposition Five .....	123
5.9	RESULTS: RESEARCH PROPOSITION SIX - DEFINED STAGES OF DECLINE DISTRESS CAN BE IDENTIFIED, WHICH IMPACT THE SUCCESS OF THE BUSINESS RESCUE PROCEEDINGS.....	124
5.9.1	Introduction and Overall Results.....	124
5.9.2	Life cycle or phase of business .....	125
5.9.3	When is a business financially distressed .....	126
5.9.4	Warning signs and metrics to identify financial distress.....	126
5.9.5	When to file .....	127
5.9.6	Conclusion to Research Proposition Six.....	128
5.10	FUTURE OF PCF.....	128
5.10.1	Future of PCF.....	128
5.10.2	Suggestions for the future of PCF .....	129
5.11	CONCLUSION.....	130
	<b>CHAPTER 6 DISCUSSION OF RESULTS.....</b>	<b>131</b>
6.1	INTRODUCTION .....	131
6.2	RESEARCH PROPOSITION ONE - INTERNATIONALLY THERE ARE CLEAR PRESCRIPTIVES FOR POST-COMMENCEMENT FINANCE .....	132
6.3	RESEARCH PROPOSITION TWO - THE EXTENT OF POST-COMMENCEMENT FINANCE FOR BUSINESS RESCUE IN SOUTH AFRICA IS NON-EXISTENT .....	134
6.3.1	Trade Creditors.....	136
6.3.2	Commercial Banks .....	136
6.3.3	Private Equity Firms (“PE”) and Distressed Debt Financiers (“DDF”).....	137
6.3.4	Private Market Lenders / Finance Companies.....	137
6.3.5	Customers .....	137
6.3.6	Shareholders .....	138
6.3.7	Development Finance Institutions.....	138
6.4	RESEARCH PROPOSITION THREE - POST-COMMENCEMENT FINANCE HAS CLEAR PHASES ....	138
6.5	RESEARCH PROPOSITION FOUR - PREREQUISITES FOR SUCCESSFUL POST-COMMENCEMENT FINANCE CAN BE IDENTIFIED .....	141
6.6	RESEARCH PROPOSITION FIVE - THE REASONS FOR LENDERS’ DISINTEREST IN POST-COMMENCEMENT FINANCE ARE CLEAR .....	143
6.6.1	The impact of the profile and actions of the Business rescue practitioner (ranked # 1).....	143
6.6.2	Business rescue filing by distressed businesses for wrong purpose and too late (ranked # 2) .....	144

6.6.3	Distressed business should involve and engage Financiers upfront prior to filing for business rescue (ranked # 8) .....	144
6.6.4	State of the relationship of financier with management and the BRP (ranked # 9).....	144
6.6.5	The availability of security (ranked # 10) .....	144
6.6.6	Financiers do not have comfort in the rescue plan based on a viable business (ranked # 11). .....	145
6.6.7	Business rescue culture and perceptions of business rescue in South Africa (ranked # 3)	145
6.6.8	Concerns and uncertainty regarding the priority ranking of PCF (ranked # 4).....	145
6.6.9	Banks are conservative and risk averse due to regulations such as Basel (ranked # 5) ....	146
6.6.10	Financier risks losing money (ranked # 6).....	146
6.6.11	Lack of cooperation by banks during business rescue proceedings (ranked # 7) .....	147
6.7	RESEARCH PROPOSITION SIX - DEFINED STAGES OF DECLINE CAN BE IDENTIFIED, WHICH IMPACT THE SUCCESS OF THE BUSINESS RESCUE PROCEEDINGS. ....	148
6.8	CONCLUSION.....	150
<b>CHAPTER 7 CONCLUSION .....</b>		<b>152</b>
7.1	INTRODUCTION .....	152
7.2	RESEARCH BACKGROUND AND OBJECTIVES.....	152
7.3	MAIN FINDINGS.....	153
7.3.1	Critical pre-filing procedures: Early consultation, viability assessment and pre-packaged financing .....	153
7.3.2	The impact of the newness of the legislation: lack of understanding and awareness, deficiency of case law and legal precedents as well as companies incorrectly filing .....	154
7.3.3	Ambiguities in the legislation and uncertainties in the industry.....	155
7.3.4	The availability of security and related losses for financiers .....	155
7.3.5	The role of the BRP on the ability to raise PCF: experience, knowledge and ability to prepare a sound rescue plan .....	156
7.3.6	Dominant (and potentially adverse) role of the banks.....	156
7.4	RECOMMENDATIONS FOR STAKEHOLDERS.....	157
7.4.1	Business (i.e. Directors and Management of Distressed Businesses).....	157
7.4.2	Business rescue practitioners.....	157
7.4.3	Financiers.....	158
7.4.4	Government (i.e. DTI, CIPC, IDC, DBSA etc.).....	158
7.5	PROPOSED FRAMEWORK: PRIMARY INFLUENCERS OF PCF.....	158
7.6	LIMITATIONS OF THE RESEARCH.....	159
7.7	RECOMMENDATIONS FOR FUTURE RESEARCH.....	160
7.8	CONCLUSION.....	162
<b>REFERENCES .....</b>		<b>164</b>
<b>APPENDIX 1 – LIQUIDATION STATISTICS .....</b>		<b>169</b>
<b>APPENDIX 2 – SECTION 135 OF CHAPTER 6 OF THE COMPANIES ACT 71 OF 2008.....</b>		<b>170</b>
<b>APPENDIX 3 – LIST OF INTERVIEWEES.....</b>		<b>171</b>
<b>APPENDIX 4 – INTERVIEW GUIDE .....</b>		<b>173</b>

<b>APPENDIX 5 – PRE-INTERVIEW PACK.....</b>	<b>182</b>
<b>APPENDIX 6 – LETTER OF CONSENT .....</b>	<b>184</b>
<b>APPENDIX 7 – POST-INTERVIEW THANK YOU NOTE.....</b>	<b>186</b>
<b>APPENDIX 8 – DETAILED RESULTS: RESEARCH PROPOSITION ONE.....</b>	<b>187</b>
<b>APPENDIX 9 – DETAILED RESULTS: RESEARCH PROPOSITION TWO .....</b>	<b>189</b>
<b>APPENDIX 10 – DETAILED RESULTS: RESEARCH PROPOSITION THREE .....</b>	<b>196</b>
<b>APPENDIX 11 – DETAILED RESULTS: RESEARCH PROPOSITION FOUR .....</b>	<b>197</b>
<b>APPENDIX 12 – DETAILED RESULTS: RESEARCH PROPOSITION FIVE.....</b>	<b>202</b>
<b>APPENDIX 13 – DETAILED RESULTS: RESEARCH PROPOSITION SIX.....</b>	<b>210</b>

## LIST OF TABLES

TABLE 1: TIMELINE OF FINANCIAL DISTRESS (CORPORATE RENEWAL SOLUTIONS, 2011B)	16
TABLE 2: COMPARISON OF PCF IN USA, UK, CANADA, AUSTRALIA AND SOUTH AFRICA	33
THESE ARE DESCRIBED IN TABLE 3 BELOW: TABLE 3: RELEVANT SITUATIONS FOR DIFFERENT RESEARCH STRATEGIES (YIN, 2003, P5)	46
TABLE 4 RESEARCH DESIGN COMPONENTS BASED ON THE DESIGN DESCRIPTION OF YIN (2003, P21)	48
TABLE 5 QUALITATIVE GENRE AND OVERALL STRATEGY (MARSHALL & ROSSMAN, 2006)	49
TABLE 6: HOW THE RESEARCH QUESTIONS RELATE TO THE PROPOSITIONS	56
TABLE 7: INTERVIEW STATISTICS	64
TABLE 8: SUMMARISED RANKING OF PRESCRIPTIVES FOR SUCCESSFUL PCF CITED BY COUNTRY	66
TABLE 9: SUMMARY OF KEY INTERNATIONAL PRESCRIPTIVES BY COUNTRY	74
TABLE 10: SUMMARISED REASONS FOR THE CURRENT EXTENT OF PCF (BRP RESPONSES)	76
TABLE 11 SUMMARISED REASONS FOR THE CURRENT EXTENT OF PCF (FINANCIER RESPONSES)	77
TABLE 12: SUMMARISED RESPONSES FOR THE NATURE OF PCF: DEFINITION OF PCF	78
TABLE 13: SUMMARISED RESPONSES NATURE OF PCF: TYPICAL FINANCIERS	79
TABLE 14: SUMMARISED FINDINGS FOR THE KEY PHASES OF PCF	91
TABLE 15: SUMMARISED RANKING OF PREREQUISITES FOR SUCCESSFUL PCF FROM BRPs AND FINS	94
TABLE 16: SUMMARISED RANKING FOR THE REASONS FOR DISINTEREST IN PCF BY LENDERS FROM BRPs AND FINS	105
TABLE 17: SUMMARISED ELEMENTS OF THE STAGES OF DECLINE	124
TABLE 18: REVIEW OF SPECIFIC FINANCE REQUIREMENTS IN EACH PHASE OF PCF	139

## LIST OF FIGURES

FIGURE 1: BR STATISTICS (MAY 2011 – MARCH 2012) .....	4
FIGURE 2: SUCCESSES VS. LIQUIDATIONS (MAY 2011 – MARCH 2012).....	5
FIGURE 3: SUMMARY OF TIMELINE OF FINANCIAL DISTRESS (OWN COMPILATION).....	17
FIGURE 4: TIMELINE OF FINANCIAL DISTRESS (CORPORATE RENEWAL SOLUTIONS, 2011B) .....	17
FIGURE 5: HIERARCHY OF CLAIMS .....	27
FIGURE 6: PRIVATE EQUITY FINANCING STAGES (VAN DER WALT, 2006) .....	42
FIGURE 7: STAGES OF DECLINE (ADAPTED - OWN COMPILATION).....	149
FIGURE 8: PRIMARY INFLUENCERS OF PCF (OWN COMPILATION).....	159

# CHAPTER 1 INTRODUCTION TO THE RESEARCH PROBLEM

## 1.1 Research Title

The status of post-commencement finance (“PCF”) for Business rescue in South Africa.

*Every morning in Africa, a gazelle wakes up. It knows it must run faster than the fastest lion or it will be killed.*

*Every morning a lion wakes up.*

*It knows it must outrun the slowest gazelle or it will starve to death.*

*It doesn't matter whether you are a lion or a gazelle.*

*When the sun comes up, you better start running.*

**- Thomas L. Friedman; *The World Is Flat***

## 1.2 Research Problem

### 1.2.1 *Declining Trading Conditions*

With the onset of globalisation in the world marketplace, the fundamental principles on which business operates have changed substantially. This has created many opportunities for businesses but has also increased the complexity of the environment within which to do business. This has largely been due to the new geographies, political dispensations, new business and market rules, diverse cultures and many other factors. Some businesses have thrived in this new context, whilst others have struggled to remain competitive.

The recent global financial crisis and subsequent recession has accelerated the decline of already struggling businesses, but also unexpectedly shook the foundations of large stable organisations that were perceived to be ‘unsinkable’. This catastrophic impact was also visible in the financial collapse of some of the world’s most resilient economies.

Corporate failures have become a harsh reality of undertaking business today and the effects of the crisis, which started in 2008, have accelerated the downward trend. Even

though businesses and governments are on the slow fragile path to economic recovery; numerous organisations are still facing financial distress and bankruptcy.

In light of the above factors, many organisations have had to respond rapidly to these challenges and craft their own business rescue and turnaround strategies. As a result, particularly during recessions or economic downturns, the concept of corporate renewal and business rescue has become an integral element of the strategy of organisations.

In the South African context, the number of liquidations and insolvencies is an important barometer regarding the general health and fortunes of businesses in the country. According to Statistics SA, the total number of firms that have been liquidated / declared insolvent increased from 3225 / 1642 in 2005 to 3992 / 4020 in 2010, which is a 23% (144%) increase (Statistics South Africa, 2012) over a period of five years. Refer to **Appendix 1 Figure 1 and 2** for more details on these statistics. The considerable increase in liquidations over the past few years, suggests an increasing trend of financial distress amongst South African companies.

### **1.2.2 New rescue legislation**

Governments around the world generally have a vision of supporting the health of the economy for the benefit of business and society, as well as creating a conducive environment in which businesses can create jobs. However largely due to the above mentioned adverse trading conditions, governments are increasingly playing a greater role in the local economy through the regulation of businesses. The intention is to prevent businesses from entering into financial distress, but also to support businesses that are already distressed. International Insolvency reform over the past 20 years; supported by policy makers, politicians and practitioners; has mainly focussed on corporate rescue, through the development of legislation focussed on business reorganisations (Vriesendorp & Gramatikov, 2010). This was first seen in countries such as the United States (Chapter 11 of the Bankruptcy Code, 1978) and the United Kingdom (The Cork Report, 1982) who was leading the way by establishing corporate rescue regimes in the respective countries. As a result of this neighbouring countries such as Canada have followed the USA; and Commonwealth countries such as Australia have developed their own rescue legislation to support businesses in distress, and to regulate the claims of creditors in these situations. Today almost all modern democracies have established statutory corporate rescue procedures with the purpose of providing protection for insolvent corporate businesses.

It is noteworthy that international organisations such as the World Bank and the United Nations have also been active in the debate about providing support for organisations in distress. These organisations consider rescue legislation as a part of an effective insolvency regime and have responded by providing guidelines and principles regarding insolvency, liquidation and ultimately business rescue. The World Bank issued ‘Principles and Guidelines for Effective Insolvency and Creditor Rights Systems’ in 2001, and is in the process of updating the ‘Revised Insolvency & Creditor Rights Principles (Draft 2005)’. The United Nations’ Commission on International Trade Law (“UNCITRAL”) also issued their ‘Legislative guide on insolvency law’ in 2004.

Both the World Bank Guide and the UN Guide emphasise the following point in their publications: “The rescue of a business preserves jobs, provides creditors with a greater return based on higher going concern values of the enterprise, potentially produces a return for owners and obtains for the country the fruits of the rehabilitated enterprise. The rescue of a business should be promoted through formal and informal procedures.” (World Bank, 2005, p. 6). As well as “Also, long-term economic benefit is more likely to be achieved through reorganization proceedings, since they encourage debtors to take action before their financial difficulties become severe. Lastly, there are social and political considerations that are served by the availability of reorganization proceedings which protect, for example, the employees of a troubled debtor.” (UNCITRAL, 2005, p. 28).

South Africa also responded to these guidelines by researching global best practice in this domain, with the intention to institute their own local rescue legislation. The predecessor to the current South African rescue legislation was the judicial management provisions in the Companies Act 46 of 1926. However due to the perceived failure of this legislation and the apparent lack of use thereof, a call for the reform of corporate rescue legislation was instituted, and the Department of Trade and Industry in South Africa published guidelines in 2004 for corporate law reform.

South Africa therefore followed suit with the introduction of the new South African Companies Act 71 of 2008 (Republic of South Africa, 2008). The Act which came into effect in May 2011 contains a new chapter which is referred to as *Chapter 6: Business rescue and Compromise with Creditors* (Republic of South Africa, 2008). This chapter effectively replaced the judicial management procedures from the Companies Act of 1973. The aim and purpose of the new chapter is to provide companies in financial distress with an opportunity to reorganise and restructure, and therefore maximise their chances of continuing to trade.

In essence the major emphasis of the chapter is the appointment of a business rescue practitioner (“BRP”) to a company in financial distress, the creation (and subsequent approval) of a business rescue plan (to the extent that it is believed that the business is still economically viable); as well as to invoke a temporary moratorium on the rights of the creditors / claimants against the company. The objective of the rescue plan is to maximise the likelihood of the company continuing on a solvent basis, else to result in a better return for the company’s creditors or shareholders as opposed to liquidation.

An interesting observation is that the rescue legislation was written into the Companies Act rather than Insolvency or Liquidation legislation, emphasising the distinction of rescue from the country’s historically “creditor-friendly” legislation. This is a unique feature of the South African legislation in comparison with equivalent international legislation.

### 1.2.3 Successes and failures of business rescue cases in South Africa

Since the incorporation of the new legislation in May 2011, the Companies and the Intellectual Property Commission (“CIPC”) have published some statistics concerning the business rescue case results as follows (CIPC, 2012):

**Figure 1: BR Statistics (May 2011 – March 2012)**

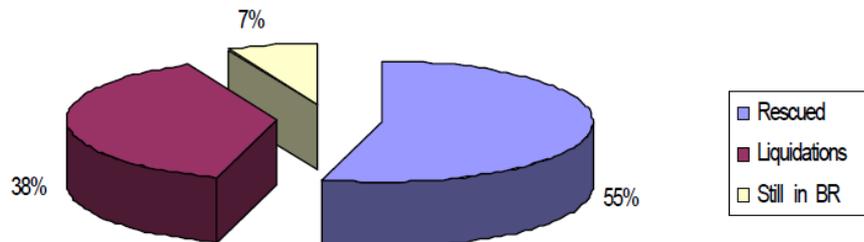
	M/June	Jul	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Tot	
<b>B u s i n e s s  R e s c u e</b>	Notices of Beginning Business Rescue Filed (129) and Court Applications	38	33	30	74	25	41	59	65	44	29	438
	Registration Certificates issued and BR appointed	3	28	50	86	25	38	39	13	33	23	338
	Discarded not valid filings	0	0	4	0	0	0	20	1	0	2	27
	CoR 125.2 Notice to end Rescue Proceeding		1	1	2	6	0	6	47	0	0	63
	Accredited Practitioners											84
	Terminations											63
	Enquiries received including phone		60	44	76	65	60	50	85	84	368	829
	Applications for practitioners licenses received	45	42	27	21	18	20	7	2	14	6	202

According to Pelsler (2012), in the first year of the new rescue legislation, there have been 613 successful rescue applications and 438 businesses that eventually followed the route of business rescue, instead of liquidation. Furthermore, an encouraging 970 jobs have been saved through successful business rescue proceedings (CIPC, 2012).

Presently, it is not possible to determine the number of jobs that have been lost due to failed business rescue proceedings.

In terms of the success rate of Business rescue Projects, the CIPC (2012) have published the following statistics:

**Figure 2: Successes vs. Liquidations (May 2011 – March 2012)**



Pelser further quoted the CIPC by stating that approximately 55% of businesses are successfully rescued. He explained that this number could be even higher were it not for the “abuse” of the mechanism, as well as the fact that institutional lenders still need to embrace the new legislation (Pelser, 2012).

This percentage should be interpreted cautiously as it is based on a sample of only 120 cases, where the risk of response bias is high, due to the successful nature of these cases.

In 2012 a few high profile business rescue cases caught the attention of the media and the general public, stimulating an interest into the understanding and impact of business rescue for businesses in South Africa. These examples include Velvet Sky airlines who filed for business rescue in February 2012, following BP South Africa’s application to have the low-cost airline provisionally liquidated due to outstanding debts amounting to R29m. Unfortunately the application for business rescue was dismissed by the courts in May 2012 due to the fact that the application “provided scant detail and might be a ploy to delay liquidation proceedings” (SAPA, 2012, p. 1).

Later in July 2012, the financially distressed construction group Sanyati applied for Business rescue following a number of government departments who failed to settle long-outstanding debts on their contracts. In this case, 96% of the voting interests rejected the proposed business plan, and therefore resulted in the termination of the business rescue proceedings (Odendaal, 2012).

Finally in August 2012 a second airline, 1Time Holdings, filed for business rescue due to financial distress experienced in its subsidiaries. The business rescue proceedings

were sadly terminated on 2 November 2012, when the second low cost airline filed for liquidation in the same year.

#### **1.2.4 *The need for turnaround finance***

In any rescue regime, a degree of financial support is required from the commercial environment through the provision of additional funding and requesting existing creditors to postpone or compromise their claims (Vriesendorp & Gramatikov, 2010). Based on this fact, rescue regimes become constrained during times of general economic turndown (as was seen in the 2008 global financial crisis) as the credit crunch becomes an obstacle for accessing financial resources (Vriesendorp & Gramatikov, 2010). Paradoxically, when rescue is needed most, businesses struggle to obtain additional credit, or the creditors themselves are financially stressed (Vriesendorp & Gramatikov, 2010). A recent example of this includes the failed application for business rescue by low-cost airlines Velvet Sky, who's CEO was quoted as saying "daily expenses could be met if possible foreign investors provided funds and if there was cost cutting" (SAPA, 2012, p. 1). In all three the failed rescues described above, the inability to raise PCF was cited as the main reason for the failure. This was echoed by the CEO of 1Time in his statement to the press: "a potential financier notified us this afternoon that they are no longer able to invest in our airline. It is therefore with the utmost regret, disappointment and heartfelt disbelief that we have to file for liquidation, which means the end of a dream and an era for all of us." (Hedly, 2012).

Therefore one of the critical components of the business rescue plan involves securing turnaround finance to meet short-term trade obligations (such as working capital requirements), covering turnaround/restructuring costs, and restoring the company's balance sheet to solvency (Corporate Renewal Solutions, 2011a).

Recent research suggests that the lack of post-filing finance and PCF is one of the prevalent five reasons why business rescues in South Africa have failed (Pretorius, 2012). Obtaining turnaround finance and returning the business to liquidity presents a challenge for financially distressed organisations and therefore the first port of call is normally internal turnaround funding (Corporate Renewal Solutions, 2011a). This often includes working capital reductions and asset realisation. If further financing is required, then existing funders are approached for loan financing which may include re-financing and moratorium agreements. However loan financing is often a challenge as these institutions are frequently trying to minimise risk, not increase it, and require

unencumbered assets as surety (something the distressed organisation normally does not have) (Corporate Renewal Solutions, 2011a). The last resort is to approach new funders to invest in the business which include private equity, business rescue funds, sale and leasebacks. However, these organisations (particularly private equity) are either not well developed in South Africa, or are reticent to fund a distressed business (Corporate Renewal Solutions, 2011a). Therefore, distressed organisations in South Africa have increased difficulty in attracting turnaround finance in the form of loan capital and private equity capital. Therefore if they are not able to obtain the funding, it ends in the ultimate demise of their turnaround prospects.

Section 138 of Chapter 6 of the Companies Act No. 71, 2008 provides for PCF, which ranks in preference to existing unsecured claims against the debtor company (Republic of South Africa, 2008). The ranking of PCF is an attempt by the legislators to stimulate turnaround financing for these distressed business. A similar concept is prevalent in the equivalent United States Chapter 11 provisions, which provides for debtor-in-possession (“DIP”) financing.

### **1.2.5 Closing**

There are obvious benefits to business rescue that have been introduced in this research study. It is evident that the new business rescue legislation would support the South African government’s overall macroeconomic policy of economic growth and employment creation (or preservation at the very least), as well as improve the economic plight of its citizens. The legislation appears to have already been effective upon inspecting the liquidation statistics since its introduction i.e. liquidations for the 12 months ending May 2011 was 3 742 compared to the equivalent period in May 2012 of 3 378 liquidations for the 12 months (Statistics South Africa, 2012). Furthermore the September year on year comparison has indicated a 28% decline (Statistics South Africa, 2012). Some commentators therefore believe that the reason for the decrease in liquidations was because of the new rescue legislation (Pelser, 2012). Pelser (2012) further stated that one of the largest stumbling blocks for the new regime is the ability to secure capital. Initial exploration of a sample of business rescue plans (Pretorius, 2012) suggest low levels of post-commencement financing and therefore the status needs to be investigated and compared to best practice for international standards.

### 1.3 Research Aim

The motivation for the study is to better understand how South African specialist practitioners and other business rescue professionals currently approach the problem of post-commencement financing and how this impacts their decision making about strategies for the rescue of businesses. Associated with this is the exploration and confirmation of factors that result in successful post-commencement financing that is underwritten by parties that are interested in the financing of these businesses.

Knowledge from this study will add to the existing body of knowledge with regard to business rescue and turnaround in South Africa. In addition it will add to more effective business turnarounds, which in turn have a positive impact on the macro-economic and growth objectives of South Africa.

Furthermore, Pretorius (2009) argued that the field of business failure as a research domain has experienced a recent resurgence, illustrated by the addition of two special editions of journals, namely the *Journal of Business Venturing* and *Long Range Planning*. The introduction of the significant new business rescue legislation in South Africa further reinforces the importance of the focus of research on turnaround situations and strategies.

### 1.4 Research Objectives

International research, described in Chapter 2, has demonstrated that business rescue legislation has certain prerequisites for successful post-commencement financing. This study aims to find substantive evidence that the presence of post-commencement finance in South African companies does not exist, as opposed to the findings of international research, where post-commencement finance is actively raised. The above motivation leads to a crucial research problem, which this research study attempts to answer, i.e. *What is the status (i.e. nature and extent) of post-commencement finance requirements in South Africa?* More specifically, questions that beg to be answered through this research study include *what are the types and sources of financing required for a business that has filed for business rescue?*, as well as a discussion of some of the critical success factors for advancement of financing by the creditors/lenders. And the last question that will be explored in this research study is, *what are the reasons for lenders' disinterest in financing businesses who have filed for business rescue?*

Therefore, the overall research objectives for the study are:

- To describe the nature of PCF in South Africa.
- To describe the extent of PCF in South Africa.
- To provide reasons for the current extent of PCF in South Africa.
- To identify the current best practice that will result in the successful advancement of PCF in South Africa.

## **1.5 Research Scope**

The scope of this study is limited to the financing practices of financially distressed South African companies that have entered into formal business rescue proceedings since the introduction of the legislation in May 2011. It will include companies operating across a range of sectors and industries. This will be done through an exploratory analysis based on interviews with ten experts in the field of business rescue, as well as eight experts from different financing institutions (e.g. Banks, development funding institutions, private equity investors etc.).

## CHAPTER 2 LITERATURE REVIEW

### 2.1 Introduction to Post-Commencement Finance

The previous chapter introduced the theme of the requirement of finance for businesses in distress, as well as the current legislation that is in place internationally (and more recently locally) in this regard. It outlined the relevance of the subject for businesses in South Africa and beyond, as well as the academic motivation for this study. It has been noted that the literature on business rescue has emerged from a largely ‘developed world’ paradigm, with very little research focused on why and how it takes place in a developing market context.

This chapter reviews the theoretical base concerning financing in business rescue locally and internationally. The literature review allows for the formulation of more detailed research propositions about the current state of PCF in South Africa, the typical phases and success factors, as well as reasons for disinterest in PCF by financiers.

The chapter commences by defining vital terms and concepts in the field of business rescue, such as distress, decline, failure and similar terms. A brief description of the typical life cycle of a business, and the importance of rescue financing for a business in distress is then provided. A description of the *status quo* of rescue financing in four other countries, namely Australia; Canada; the United Kingdom (UK) and the United States of America (USA) follows. From these studies, the researcher is able to discern the current status of financing in business rescue in South Africa, or the apparent lack of financing business rescue in the developing country.

The main reasons why these countries were selected are:

- i. Business rescue developments in these countries represent some of the latest developments internationally.
- ii. The four countries selected are English-speaking countries. This made research resources more accessible and comprehensible and should result in more accurate data.
- iii. Because South Africa has a nascent business rescue industry, it is important to review countries that had well developed business rescue systems.
- iv. South Africa’s current business rescue legislation was largely developed from the best practice in these countries.

- a. The USA was selected as it is credited with initiating the modern day changes in the area of business rescue.
- b. Due to the similarities in law between the UK and South Africa, the UK was also selected.
- c. The similarity of Chapter 6 to the Australian legislation, as well as the fact that Australia borrowed judicial management from the South African system in order to introduce some form of rescue procedure, but was subsequently removed due to high failure rates. They have since introduced business rescue provisions as they are practised today.
- d. A team of Canadians wrote the South African rescue provisions in Chapter 6.

The objective of this literature review was to analyse the research problem from an international perspective. The research problem involves certain international principles and it follows that international practices can contribute to local developments. The chapter then concludes with some prerequisites for successful financing, explains the current mind-set of South African financiers, and how the stage of decline impacts the success of the business.

## 2.2 Definitions and concepts in business rescue

Before exploring the current landscape of financing in business rescue, it is important to define vital terms and concepts in the field. The aim of explaining these definitions is to ensure clarity of the relevant concepts for use in this study.

There are many different definitions of the concept of turnaround found in different studies on business/corporate failure, distress and renewal. These are scattered in the fields of management, finance and entrepreneurship, to name only a few.

### 2.2.1 *Business Decline and Failure*

Pretorius (2009, p. 10) defined decline and failure as follows:

***Decline:*** A venture is in decline when its performance worsens (decreasing resource slack) over consecutive periods and it experiences distress in continuing operations. Decline is a natural precursor in the process to failure.

***Failure:*** A venture fails when it involuntarily becomes unable to attract new debt or equity funding to reverse decline; consequently it cannot continue to operate under the

*current ownership and management. Failure is the endpoint at discontinuance (bankruptcy) and when it is reached, operations cease and judicial proceedings take effect.”*

Therefore it is important to identify when a company is in decline, to prevent the inevitable failure thereof, should rescue or turnaround interventions not be instituted timely.

### **2.2.2 Financially Distressed**

The definition of being financially distressed in reference to a particular company at any particular time, means that—as found in the Companies Act 71 of 2008, Chapter 6, Section 128 (f) is: (Republic of South Africa, 2008, p. 230)

*““**financially distressed**”,*

*(i) it appears to be reasonably unlikely that the company will be able to pay all of its debts as they fall due and payable within the immediately ensuing six months; or*

*(ii) it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months.”*

Therefore Chapter 6 clearly defines financial distress in terms of two criteria for a six month period; i.e. primarily not being able to pay its debt; as well as becoming insolvent. This indicates that the organisation is in decline and may be heading for failure.

### **2.2.3 Business rescue**

In order to avoid failure, a company should file for business rescue in good time if it is financially distressed. Business rescue, as defined by the Companies Act 71 of 2008, Chapter 6, Section 128 (b) is: (Republic of South Africa, 2008, p. 230)

*““**business rescue**” means proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for—*

*(i) the temporary supervision of the company, and of the management of its affairs, business and property;*

*(ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and*

*(iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results*

*in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company".*

Therefore the purpose of business rescue is an attempt to assist a financially distressed business in the hope that it will emerge from the rescue procedure in a position to satisfy the claims of creditors more effectively, as opposed to the immediate liquidation of the company (Republic of South Africa, 2008). Business rescue proceedings can commence through a board of directors filing for rescue, or alternatively through an "affected person" (shareholder, creditor, registered trade union or employee not represented by a registered trade union) applying to the court for business rescue proceedings to commence (Republic of South Africa, 2008).

Therefore, should an organisation identify that they meet the definition of financially distressed as described above, the directors are compelled to either file for business rescue as mentioned above, or they should send out a notice to all affected persons as to the reasons why they are not filing, as per section 129(7) (Republic of South Africa, 2008).

#### **2.2.4 Post-commencement financing**

To ensure that the business completes a successful turnaround, it is important to secure financing. One of the key requirements that need to be expanded on in the rescue plan is the magnitude and nature of the financing required to rescue the business, which is referred to as post-commencement finance. The definition of post-commencement financing consistent with the Companies Act 71 of 2008, Chapter 6, Section 135 is: (Republic of South Africa, 2008, p. 240)

*"(1) To the extent that any remuneration, reimbursement for expenses or other amount of money relating to employment becomes due and payable by a company to an employee during the company's business rescue proceedings, but is not paid to the employee—*

*(a) the money is regarded to be **post-commencement financing**;... AND*

*(2) During its business rescue proceedings, the company may obtain **financing other than as contemplated in subsection (1)**, and any such financing—*

*(a) may be secured to the lender by utilising any asset of the company to the extent that it is not otherwise encumbered; and*

*(b) will be paid in the order of preference set out in subsection (3)(b).*

*(3) After payment of the practitioner’s remuneration and costs referred to in section 143, and other claims arising out of the costs of the business rescue proceedings, all claims contemplated—*

*(a) in subsection (1) will be treated equally, but will have preference over—*

- i. all claims contemplated in subsection (2), irrespective whether or not they are secured; and*
- ii. all unsecured claims against the company; or*

*(b) in subsection (2) will have preference in the order in which they were incurred over all unsecured claims against the company.*

*(4) If business rescue proceedings are superseded by a liquidation order, the preference conferred in terms of this section will remain in force, except to the extent of any claims arising out of the costs of liquidation.”*

It can be interpreted that unpaid claims by employees related to employment or reimbursements of expenses, is considered PCF which carry a super-priority status in the Act. Furthermore, the ranking of claims in terms of the Section 135 provisions are as follows (Republic of South Africa, 2008):

1. The Business rescue practitioner’s remuneration and costs (as per section 143) arising from business rescue proceedings (section 135(3)); then
2. All other claims from costs of business rescue proceedings; then
3. All PCF claims related to employment once business rescue has commenced; then
4. Secured lenders/creditors pre-business rescue; then
5. All secured PCF claims related to third party lenders / creditors (section 135(3)(a)(i));
6. Insolvency Act preferences; then
7. Unsecured claims by PCF or lenders/creditors during business rescue in the order they were incurred (section 135(3)(b));
8. Remuneration of employees which became due and payable before business rescue commenced (section 144(2)); and then
9. All unsecured claims against the company.

There has been substantial debate on the order of the claims described above, due to the fact that the ranking of the underlined items not being explicitly mentioned in the Act. The waterfall of payments has also not yet been tested or pronounced in the South African courts, hence the uncertainty. The biggest uncertainty exists with regards to point four and five and whether they should be swapped. The current understanding is however that pre-rescue secured claims rank ahead secured PCF,

and that PCF generally enjoys a priority status when new financing provided is by lenders, above that of unsecured claims / creditors, making it a very important vehicle in the rescue of a business in financial distress.

Further uncertainty exists with regards to the ranking of the South African Revenue Services (“SARS”) as this is not explicitly mentioned in the Act either. However a recent case pronouncement explained that should the approved rescue plan assign SARS as a creditor with no priority, then they will be ranked as such, unless they have a majority vote to reject the plan (South African Revenue Services, 2012).

It is noted that PCF is also referred to as Post-Petition Financing (“PPF”) or Debtor-in-possession Financing (“DIP Financing”).

Should the rescue plan be successfully voted in, then the company will enter its turnaround plan and head onto the road of improved liquidity, probability and sustainability.

### **2.2.5 Turnaround**

Pretorius (2009, p. 11) defined turnaround as follows:

*“**Turnaround:** A venture has been turned around when it has recovered from a ‘decline that threatened its existence’ to resume normal operations and achieve performance acceptable to its stakeholders (constituents) through reorientation of positioning, strategy, structure, control systems and power distribution. Return to positive cash flow is associated with achievement of ‘normal operations’.”*

In light of the above definitions, it is evident that firms that are in decline still have the opportunity to turnaround, if they have not failed already. Therefore the distinction between the different phases of decline of businesses is critical.

Management also need to have an awareness of the different cycles a business goes through in order to identify when they have entered a decline in the cycle.

## **2.3 Overview of the life cycle of a business in distress**

In the context of the definitions described above and the nature of business rescue and PCF, it is important to understand what the different stages of decline a company in financial distress experiences until ultimate business failure. Corporate Renewal Solutions (2011b) referred to a “timeline of financial distress”, where a business can move from an informal turnaround (which occurs outside the legal frameworks of the

Companies Act and Insolvency Act) to a legal formal turnaround. Refer to **Table 1** below.

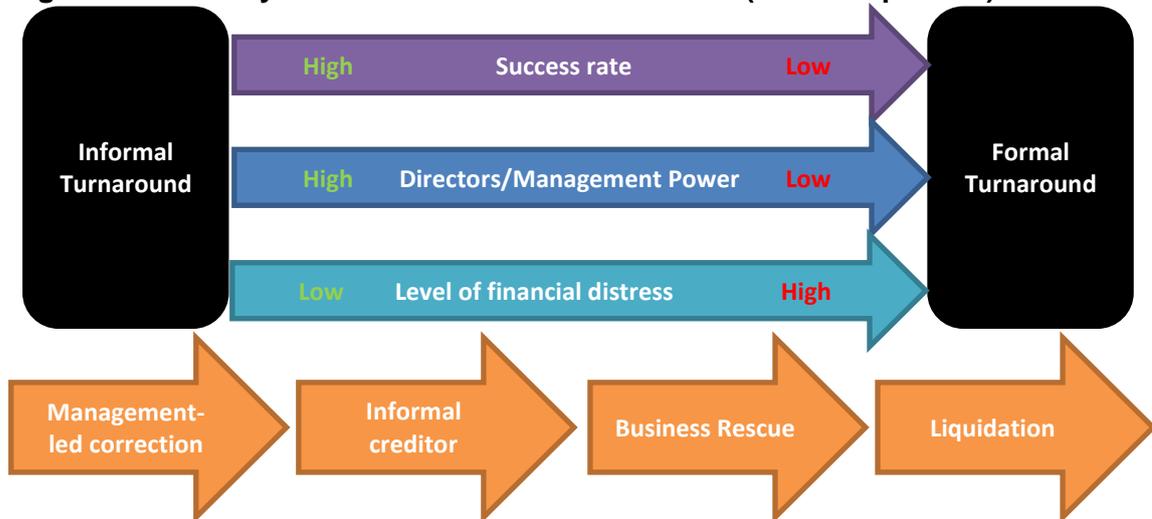
**Table 1: Timeline of Financial Distress (Corporate Renewal Solutions, 2011b)**

Turnaround and the Timeline of Financial Distress				
Informal Turnaround Processes (outside of the legal framework provided by the Companies Act and Insolvency Act)			Formal Legal Processes	
			Chapter 6 of the Companies Act No. 71 of 2008	Insolvency Act
<i>Emerging problems</i>	<i>Acute and worsening problems</i>		<i>In financial distress but economically viable</i>	<i>In financial distress and not economically viable</i>
Management-led correction		Informal creditor workout	<i>Business rescue</i>	Liquidation
Turnaround in the absence of creditor pressure.  There is no creditor pressure since the financial situation is not yet critical.	Turnaround when the financial situation is already critical, but in the absence of creditor pressure.  This is due to support from benevolent shareholders. E.g. distressed government organisations, SOEs and companies with financial support from holding companies.	Turnaround given an informal agreement, between management and creditors to reduce indebtedness.  Creditors are normally banks and institutional lenders.  Management remains in charge, but the agenda is determined by the workout agreement.	Turnaround characterised by the temporary supervision of the management of the company, a temporary moratorium on the rights of claimants against the company, post-commencement finance, cram-down of dissenting creditors, and a business rescue plan.  Chapter 6 of the Companies Act no. 71 of 2008 replaces judicial management (Sections 427 - 440 of the Companies Act No. 61 of 1973) and its Section 311 Compromise with Creditors.	No turnaround - realisation of the distressed company's assets and the distribution of proceeds to its creditors.
			<i>Business rescue types</i>	
			Pre-packaged	Free-fall
			Business rescue plan including funding largely negotiated prior to commencement of business rescue proceedings.	No pre-negotiation.

Corporate Renewal Solutions (2011b) explained that informal turnarounds have the highest success rate. As the financial situation becomes more severe and the

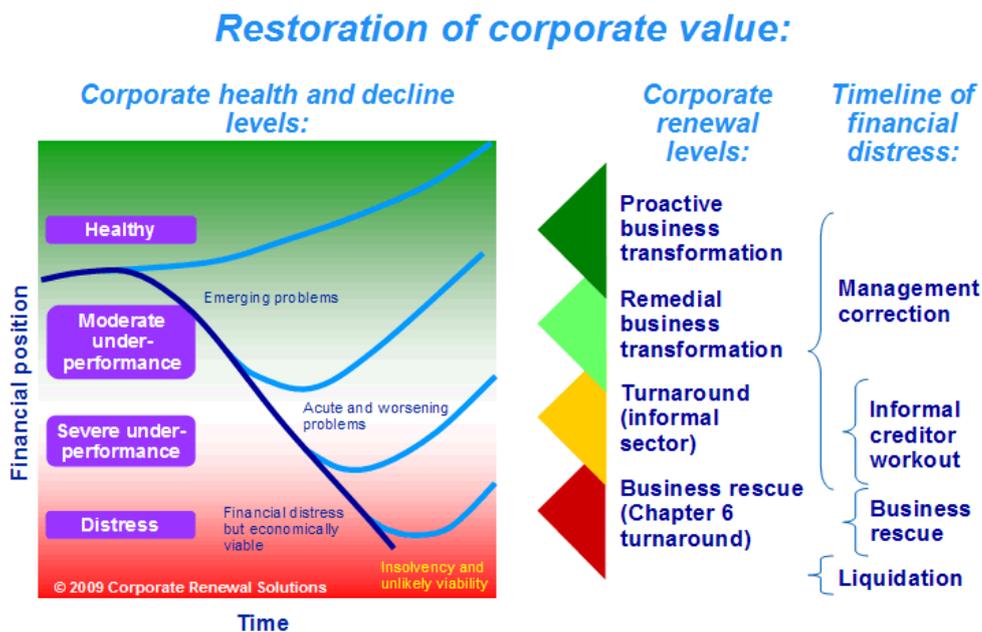
turnaround becomes more formal, the situation becomes more inflexible and expensive (Corporate Renewal Solutions, 2011b). In addition, the level of control and mandate that management have over the business is increasingly handed over to the creditors and eventually the courts (Corporate Renewal Solutions, 2011b). Therefore in summary, the main criteria at play in the timeline are as follows in **Figure 4**:

**Figure 3: Summary of Timeline of Financial Distress (own compilation)**



Furthermore, Corporate Renewal Solutions (2011b) linked the timeline of financial distress to the corporate health and decline levels, as well as the corporate renewal levels in **Figure 4** below.

**Figure 4: Timeline of Financial Distress (Corporate Renewal Solutions, 2011b)**



Pretorius (2008) offered a model that describes the phases that a company experiences during the turnaround process. The four stages and their main characterisations (which do not necessarily occur in a linear fashion) are as follows: (Pretorius, 2008)

- performing well—operating normally,
- underperformance—scarce resources and weak internal operations,
- distress—abundant resources but declining sales and loss of competitive advantage, and
- crisis—scarce resources and pressure on cash.

Therefore the key phases that a business goes through have been explored by the literature, but no clear connection has been made between the lifecycle of a typical business, and the connection with business rescue and its related stages of decline.

## **2.4 Rescue financing: Stages, importance and benefits**

### **2.4.1 Stages of rescue finance**

In deciding on the appropriate type of financing required for a successful turnaround, it is important to understand the stage of decline that the organisation is in, and match this to the corresponding financing needs.

Generally once an organisation files for business rescue, they require cash/financing to continue daily operations (e.g. salaries and wages, materials and supplies etc.) until the rescue plan is concluded. Once the plan has been accepted, the cash requirement for daily operations continues, but in addition further longer-term financing may be required to institute the rescue plan (e.g. capital expansion, settling outstanding debt etc.).

Burdette (2004) explained that there is a clear difference between the cash that is required to continue trading normally until the conclusion of the business plan, and the cash generated from the company once the plan has been accepted and instituted. He stated that it is envisaged that the leading creditor bank will assume the responsibility for funding these interim periods as well as post-commencement finance (Burdette, 2004).

Utilising the four stages outlined above by Pretorius (2008), the financing requirements for businesses in each of these situations are as follows:

- performing well—normal financing requirements, bridging for overtrading,
- underperformance—venture is cash strapped and requires restructuring financing,
- distress—requires additional funding but more risky, and
- crisis—request creditors for “debt-forgiveness”.

Due to the nature and speed of the stages described, it is therefore critical that the business rescue specialist should be engaged with promptly, before the company is on the brink of liquidation, in order to be able to recognise the warning signs and act appropriately. Furthermore, UNCITRAL (2005) explained that during rescue or reorganisation proceedings, it is critical to determine the need for new financing timeously, referring specifically to the period between the time of filing/application and the commencement of proceedings, as well as after commencement and before approval of the plan. The financing required in the period after the plan has been approved, should be addressed in the plan.

#### **2.4.2 *The options a company in distress faces***

Should a company identify warning signs early on in the decline curve, it is important for management to assess the different options that they have available to them. There are currently three different options available to a company in financial distress:

1. Commencement of formal business rescue proceedings (as described above),
2. Proceed with an informal (i.e. out-of-court resolution) creditor workout exercise (an example being the “London Approach” followed by UK banks), or
3. Apply for voluntary liquidation of its operations.

The London Approach was conceived when “Bank of England circulated a letter to banking associations in London in August 1990 with the aim of ensuring that every bank in London should be familiar with the multibank approach to supporting companies in difficulty” (BBA, 2004). Today this includes other lenders/financial institutions. This entails a moratorium on all claims outside of a formal statutory process, where no lender takes action to improve their position in relation to other banks (BBA, 2004). This creates time to for the appointed lead bank to obtain information about the business and plan for a turnaround strategy for the future (BBA, 2004).

### **2.4.3 Importance of rescue finance**

When businesses become “over-leveraged” or financially distressed, frequently for reasons beyond their control, e.g. an economic recession, access to finance becomes increasingly difficult; in some cases virtually impossible. These difficulties force distressed businesses to operate on a cash basis or confront the possibility of liquidation or forced sale of their assets. This was evidenced in the recent financial crisis where the raising of PCF / post-petition finance became a major obstacle for businesses that require rescue or reorganisation (Vriesendorp & Gramatikov, 2010).

The World Bank and others have emphasized that a business should (in terms of Principle C.9.2) “have access to commercially sound forms of financing, including on terms that afford a repayment priority under exceptional circumstances, to enable the debtor to meet its on-going business needs, subject to appropriate safeguards.” (World Bank, 2005, p. 17)

Bibeault (1999) stated that there are four significant success factors for turnaround success—these include new, competent management; viable core operation; adequate bridge financing; and improved employee motivation. From this information, it is evident that financing is one of the four significant variables in a successful turnaround. Levinthal (1991) referred to declining organisational capital as the most important determinant of firm mortality. Pretorius (2009, p10) further stated that an “intervention through...financial injection could keep a declining venture operating.” Also in agreement, van der Walt (2006) listed turnaround finance as one of the main success factors for business rescue. Therefore, financing is a critical component of the success of business rescue and of the utmost importance in the turnaround attempt.

It is apparent that it is increasingly important for a business to receive turnaround finance at the beginning of the process of financial distress, as this is directly linked to the magnitude of success of the turnaround.

### **2.4.4 Benefits to the lenders/financiers**

It is well known that the valuation of a business as a “going concern” is almost always greater than if it were to be liquidated or sold off piece meal. This means that it preserves higher economic value for the company and therefore the claims that the creditor or lender will institute will realise a higher recovery rate.

Furthermore, by preserving the organisation, jobs are preserved which in turn has a positive impact on the broader socio-economic landscape of the country through a higher number of economically active and productive citizens engaged in the economy.

Therefore it can be seen that there is some guidance available on the stages of rescue finance, however further exploration in terms of the length or timing, and type of financier is required.

## **2.5 The international perspective on PCF**

The importance of timely financing of a business in financial distress has been explored. An analysis of some of the international best practice in this area will be completed. As previously described, this section will consider best practice from the four countries under review, as well as any other global insolvency guidelines.

### **2.5.1 World Bank**

In the World Bank's publication on "Principles for Effective Creditor Rights and Insolvency Systems", one of the principles for successful post-commencement financing:

#### Principle C9: Stabilizing and Sustaining Business Operations

*"C9.2 Subject to appropriate safeguards, the business should have access to commercially sound forms of financing, including on terms that afford a repayment priority under exceptional circumstances, to enable the debtor to meet its on-going business needs."* (World Bank, 2005, p. 17).

The World Bank furthermore states that in developing countries most financing is in the form of debt, where lenders usually require security to reduce the risks of non-payment (World Bank, 2005). The security usually takes the form of movable or immovable property.

### **2.5.2 UNCITRAL**

The United Nations Commission on International Trade Law also published recommendations regarding PCF provisions included in modern international creditor and insolvency systems. These include:

### Purpose of legislative provisions:

UNCITRAL state that the purpose of provisions on PCF in rescue legislation is: (UNCITRAL, 2005, p. 118)

*“(a) To facilitate finance to be obtained for the continued operation or survival of the business of the debtor or the preservation or enhancement of the value of the assets of the estate;*

*(b) To ensure appropriate protection for the providers of post-commencement finance; and*

*(c) To ensure appropriate protection for those parties whose rights may be affected by the provision of post-commencement finance.”*

Furthermore, UNCITRAL recommend the following provisions in terms of the contents of the legislation around PCF:

### Attracting and Authorizing Post-Commencement Finance

*“63. The insolvency law should facilitate and provide incentives for post-commencement finance to be obtained by the insolvency representative where the insolvency representative determines it to be necessary for the continued operation or survival of the business of the debtor or the preservation or enhancement of the value of the estate. The insolvency law may require the court to authorize or creditors to consent to the provision of post-commencement finance.”* (UNCITRAL, 2005, p. 118).

They established the above recommendation based on the following three aspects: (UNCITRAL, 2005)

- **The Need for PCF** – It is critical for the company in distress to have access to funds to be able to pay for crucial day to day costs. This funding may come from existing liquid assets of the company or incoming cash flow from operations. Alternatively this funding should be sourced from a third party through extended trade credit or loans. These financing needs should be established early to accommodate financing requirements post filing and post acceptance of the business plan (UNCITRAL, 2005).
- **The Sources of PCF** – There is a limited number of sources, these include: (UNCITRAL, 2005)
  1. Pre-insolvency lenders or vendors of goods who provide new funds or trade credit with the intention of increasing their probability of recovering their existing claims or obtaining additional value through higher lending rates.

2. Lenders with no pre-insolvency relationship who are motivated by the potential for high returns on their lending.
- **Authorisation for PCF** – In terms of obtaining authorisation for PCF, it is noted that a number of insolvency laws permit the insolvency representative to decide that new financing is required for various purposes and is then authorised to obtain unsecured credit without approval by the court or creditors; whereas others require approval by the court or creditors (UNCITRAL, 2005). Court intervention is generally not required unless where the security or priority to be given for PCF affects the interests of existing secured creditors who do not support what is proposed (UNCITRAL, 2005).

#### Priority for post-commencement finance

*“64. The insolvency law should establish the priority that may be accorded to post-commencement finance, ensuring at least the payment of the post-commencement finance provider ahead of ordinary unsecured creditors, including those unsecured creditors with administrative priority.”* (UNCITRAL, 2005, p. 119).

They established the above recommendation based on the following aspects: (UNCITRAL, 2005)

- Expenses incurred in the operation of the business are typically entitled to be paid as administrative expenses. Administrative priority creditors usually do not rank ahead of a secured creditor, but are generally afforded a first priority ahead of ordinary unsecured creditors and any statutory priorities (e.g. taxes). If a trade creditor continues to supply credit post-filing, this new credit/lending is seen to be advanced to the insolvency representative rather than the company in distress, and therefore this credit becomes an expense of the insolvency estate, which attracts the above priority ranking.
- A “super” administrative priority provision exists in some laws where these creditors / lenders rank ahead of administrative creditors. These also include the fees of the insolvency representative or professional employed in the case.

#### Security for post-commencement finance

*“65. The insolvency law should enable a security interest to be granted for repayment of post-commencement finance, including a security interest on an unencumbered asset, including an after-acquired asset, or a junior or lower priority security interest on an already encumbered asset of the estate.”*

66. *The law should specify that a security interest over the assets of the estate to secure post-commencement finance does not have priority ahead of any existing security interest over the same assets unless the insolvency representative obtains the agreement of the existing secured creditor(s) or follows the procedure in recommendation.*

67. *The insolvency law should specify that, where the existing secured creditor does not agree, the court may authorize the creation of a security interest having priority over pre-existing security interests provided specified conditions are satisfied, including:*

- (a) The existing secured creditor was given the opportunity to be heard by the court;*
- (b) The debtor can prove that it cannot obtain the finance in any other way; and*
- (c) The interests of the existing secured creditor will be protected.” (UNCITRAL, 2005, p. 119)*

They established the above recommendation based on the following aspects: (UNCITRAL, 2005)

- When a new lender requires security it can be provided against:
  - Unencumbered assets (although there are seldom any available) or
  - As junior security on encumbered assets where there is excess value of the assets over the existing obligation.
- In the case of existing lenders, their pre-commencement priority in the encumbered asset is retained, unless they agree otherwise.
- In certain insolvency laws provisions exist where new financing is provided from a level of priority over existing secured creditors (“*priming lien*”), however this is often reluctantly provided by the courts as a last resort. It is also often subject to conditions to protect the existing secured creditors.

#### Effect of Conversion on Post-Commencement Finance

“68. *The insolvency law should specify that where reorganization proceedings are converted to liquidation, any priority accorded to post-commencement finance in the reorganization should continue to be recognized in the liquidation.” (UNCITRAL, 2005, p. 119)*

They established the above recommendation based on the following aspects: (UNCITRAL, 2005)

- When a company enters liquidation, a desirable approach is to provide that creditors obtaining priority for new funding pre-liquidation will retain priority in any subsequent liquidation. If this is not the case, the approach will be a disincentive for any party to provide new funding.

Following the global insolvency guidelines, each of the four countries' rescue regimes will be briefly unpacked, with a focus on rescue funding and PCF.

### **2.5.3 United States of America**

#### **a) General Overview**

The laws of the United States of America ("USA") are divided between Federal and State law. The Federal Bankruptcy Court administers the Bankruptcy Reform Act of 1978 ("Bankruptcy Code"). Chapter 11 is the principal chapter in the Act dealing with business rescue (United States of America, 2002). It is also known as "Corporate Bankruptcy" and applies mainly to corporates and sole proprietorships when the business is no longer able to service its debt or pay its creditors. It is therefore a form of corporate financial reorganisation which typically allows companies to continue to function while they follow debt repayment plans.

The overall aim of Chapter 11 of the Bankruptcy Reform Act of 1978 is to "preserve and protect an ailing business by encouraging a financial restructuring that is binding upon all parties" (Bracewell & Giuliani, 2012, p. 1). Chapter 11 allows the company in distress to obtain temporary relief from creditors' claims; whilst remaining in business with existing management; relook its business plan; and agree on the restructuring of its capital structure (debt and equity interests) with stakeholders to better reflect the ability of the business to create value and service debt (Bracewell & Giuliani, 2012).

In this context the organisation in distress is referred to as the "debtor". One of the unique features of this code states that the debtor retains ownership, the existing corporate governance structures remain in place and the debtor stays in control of the business in most instances, subject to the court's jurisdiction and oversight (United States of America, 2002). This is referred to as a "Debtor-in-Possession" ("DIP") (United States of America, 2002). Therefore for all intents and purposes the DIP becomes the trustee of the business. It is possible that an outside administrator (or "trustee") is appointed in the place of management in exceptional situations such as fraud, dishonesty or gross mismanagement (Gaur, 2012).

In effect the DIP runs the day to day operations of the business. Simultaneously they work with the creditors through the Bankruptcy Court to negotiate and complete a rescue plan (United States of America, 2002). Certain requirements need to be made upon which creditors vote on the proposed plan. If the plan is accepted, the debtor continues to operate as is and pay its debts under the terms of the confirmed plan. If a majority of creditors do not vote to accept a plan, a procedure referred to as a “cram down” may be imposed by the court in order to confirm the plan and bind the creditors to it, even if they do not agree (United States of America, 2002).

Couwenberg & de Jong (2006) explained that the USA has a soft, debtor-friendly system, which means that their legislation shields a company from its creditors. Therefore the court would allow the DIP to reject and cancel contracts as well as activate protection in terms of “automatic stay” (United States of America, 2002). This protects the business from any litigation or further claims from creditors against the business, until it can be resolved in bankruptcy court. The US proceedings are also driven strongly through the courts.

#### b) Financing a business in distress – Debtor-in-possession financing

The Bankruptcy Code (through Chapter 11) affords the DIP a number of mechanisms to restructure its business through section 364. DIP Financing is one of the most important mechanisms created to enable the DIP to provide current or new lenders the first priority claim on the finances (i.e. right of repayment priority) through the acquisition of financing and loans on favourable terms for the company.

DIP financing, as described above, may be incurred during the ordinary course of business transactions without court approval, else it requires court approval (United States of America, 2002). The court authorises a debtor to incur unsecured post-petition debt as a first priority administration expense or secured debt over unencumbered assets or remaining portions of unencumbered assets (Gaur, 2012). DIP financing consists mainly of cash (through secured assets), new investments and trade credit.

As lenders are reluctant to extend credit to financially troubled companies, especially those in the bankruptcy process, the rules relating to the order in which claims are paid in bankruptcy are favourable to lenders who provide DIP financing. The DIP mechanism in section 364(d) provides “super-priority” status on pre-petition assets to new lenders if they can prove that no other financing exists and that the originally secured party is still sufficiently protected (Gaur, 2012).

The hierarchy of claims found in Chapter 11 is outlined below: (Gilson, 1995)

**Figure 5: Hierarchy of claims**

**Exhibit 1. Hierarchy of Claims in Chapter 11 from Most Senior to Most Junior**

1.	Secured claims
2.	Superpriority claims (e.g., debtor-in-possession financing)
3.	Priority claims
3a.	Administrative expenses (including legal and professional fees incurred in the case)
3b.	Wages, salaries, or commissions
3c.	Employee benefit claims
3d.	Claims against facilities that store grain or fish produce
3e.	Consumer deposits
3f.	Alimony and child support
3g.	Tax claims
3h.	Unsecured claims based on commitment to a federal depository institutions regulatory agency
4.	General unsecured claims
5.	Preferred stock
6.	Common stock

Furthermore, many distressed firms opt for a “pre-packaged” (also referred to as a “pre-pack”) filing where the firm files simultaneously for bankruptcy and submits a formal reorganisation proposal for a vote by the claimholders (Gilson, 1995). This results in time being saved and works best for firms who have financial problems, rather than operational problems; and have relatively lower levels of trade debt outstanding (Gilson, 1995).

Reorganisation and rescue in the USA provides an example of a regime that has at its core the principle of debtor-friendliness and the desire to rescue the distressed business. The USA process illustrates that a debtor-friendly approach does not necessarily imply a system that is to the detriment of the creditors and that a balancing act is possible. The rationale is that if the new financing is raised, all creditors will be better off if the debtor is rescued from liquidation (Gaur, 2012). DIP financing has been criticised for operating as a lever of control over management as well as transferring value to “privileged creditors at the expense of ordinary creditors and shareholders” (Gaur, 2012, pp. 25-26).

#### **2.5.4 United Kingdom**

##### **a) General Overview**

The concept of bankruptcy in the United Kingdom (“UK”) only relates to individuals and partnerships in the legal sense. Companies and other legal entities enter into liquidation and administration. These procedures are governed by Parts I and II of the Insolvency Act of 1986, now reformed as a result of the combined impact of the Insolvency Act of 2000, as well as the Enterprise Act of 2002. The Enterprise Act of

2002 attempts to consolidate the UK laws with Chapter 11 of the USA (Gaur, 2012). The forms of administration available in the UK include a “company voluntary arrangement”, a “scheme of arrangement”, an “administrative receivership” and an “administration”. In the United Kingdom a stay of proceedings is sanctioned by the court (UK Statutes Crown, 1986).

During administration, control will be handed over to an "administrator" (a qualified insolvency practitioner), who is appointed by the company or its directors (which does not necessarily require a court order) and who must act in the interests of all the creditors with the objective of rescuing the company as a going concern and then provide the best recoveries possible for creditors (UK Statutes Crown, 1986). The administrator (as opposed to the directors) runs the business during the reorganisation period and effectively replaces the board of directors (UK Statutes Crown, 1986). Administration also imposes a statutory moratorium on specific creditor actions (Wilson & Deniz, 2008).

Another significant input into the UK’s statutory business rescue system is the Cork Report (also referred to as the “Report of the review committee in insolvency law and practice, 1982”) which recommended that English law should acknowledge the benefits from having insolvency procedures that would encourage the rescue of a company rather than focus primarily on the efficient realisation of assets (Cork, 1982). They therefore recommended a unified insolvency code to be enacted in the UK. The intention is to create a “rescue culture” which has the aim of reorganising companies in order to restore them to profitable trading and enable them to avoid liquidation.

A feature often present in administration is the concept of a “pre-packaged administration”, where the Administrator has been consulted with prior to their appointment, which often speeds up the process of accepting the reorganisation plan (Wilson & Deniz, 2008). Furthermore, there is no automatic cram down of debt and generally secured creditors only vote on the unsecured portions of their debt, whereas the Administrator’s proposals may lead to a cram down for secured creditors (Wilson & Deniz, 2008).

Couwenberg & de Jong (2006) explain that the UK has a harsh, creditor-friendly system, which means that its main objective is the repayment of creditors’ claims. The UK reorganisations generally take place outside of court proceedings.

#### b) Financing a business in distress

The UK does not have the concept of super-priority DIP Financing as is the case with the USA and therefore any additional liquidity requirements must be met by funding

from existing creditors (UK Statutes Crown, 1986). The current lending structures of the UK, as well as market practice, has prohibited the development of DIP Financing, which is demonstrated by the reticence of the UK Government to amend the existing legislation (Gaur, 2012). The UK Government also embarked on a national consultation to encourage rescue and equivalent DIP financing in 2009, however the responses to the proposal indicated a negative interest from the financing community and therefore no further action was taken (The Insolvency Service, 2009).

However although the concept of PPF is not explicitly mentioned in the Enterprise Act of 2002, it provides the administrator with the ability to exercise the management powers of borrowing money and granting security on the organisation's behalf (Gaur, 2012). This is demonstrated through the priority order of all contractual liabilities incurred by the administrator is as follows: (Gaur, 2012)

1. Loan obligations (which could include new financing arrangements)
2. Administrator's remuneration and expenses
3. Existing floating charge securities.

### **2.5.5 Canada**

#### **a) General Overview**

Corporate restructuring and reorganisation is governed by either the Companies Creditors Arrangement Act of 1985 ("CCAA") or the Bankruptcy and Insolvency Act of 1992 ("BIA"). All proceedings are administered by a superior court of each province, rather than by specialised bankruptcy courts (Grace, 2012).

The BIA is a detailed statute intended to be the complete and comprehensive code on bankruptcies. In terms of the BIA, if a bankruptcy order is made, a "Trustee" must be appointed over the property of the bankrupt party (Department of Justice Canada, 1985b). The BIA allows for companies who reside, carry out business or own property in Canada, to implement proposals with creditors (Grace, 2012). The code also provides for a "stay of proceedings" where no creditor has any remedy against the debtor or its property (Department of Justice Canada, 1985b). This allows the company flexibility to maintain operations whilst all creditors' claims are temporarily suspended (Gaur, 2012). The proposal procedure is generally less costly and takes less time to complete than the CCAA, but the rules and deadlines are more rigid and the courts have less discretion (McMillan LLP, 2009).

Conversely, the CCAA is a flexible regime which is more commonly used for large corporate restructurings. It is only available to companies with total debts of over \$5 million (Canadian dollars) who are insolvent, and has considerable judicial discretion (Department of Justice Canada, 1985a). Per the CCAA, a “monitor” is appointed in order to monitor the business and financial affairs of the business. The monitor is an independent officer of the court who reports on the progress of the reorganisation to the court (Department of Justice Canada, 1985a).

CCAA has the objective of providing the debtor company with an opportunity to move out of its financial difficulties and creates a viable alternative to bankruptcy (Department of Justice Canada, 1985a). The debtor and creditors agree on a reorganisational plan for the business which will enable the debtor to meet the creditor’s demands (Department of Justice Canada, 1985a). Companies need to first apply for an initial general stay order of 30 days, following which an extension should be applied for (Department of Justice Canada, 1985a). Therefore CCAA procedures may be more attractive when two main criteria are required: 1) there is a need for a more extensive stay period; and 2) there is a need for greater judicial discretion (McMillan LLP, 2009). The CCAA permits a company to implement a “compromise or an arrangement” with its creditors through a plan of arrangement (Grace, 2012). The law also includes provisions in the initial order which contains approval of certain priority charges such as DIP financing, professional fees and payment of statutory obligations of directors (Grace, 2012).

b) Financing a business in distress

In both the CCAA and BIA, Canada utilises the concept of DIP (i.e. super-priority charge in favour of a lender) where there must be persuasive evidence that the benefits of the financing clearly outweigh the prejudice to lenders whose security is being subordinated to the financing (Department of Justice Canada, 1985a). Although neither the BIA or CCAA currently contemplate post-petition financing (“PPF”), existing court judgements imply that a super-priority status for PPF will be approved where all existing secured creditors consent to it or where it can be provided that they will not be materially prejudiced (Gaur, 2012). The concept of DIP financing has no clear statutory basis in Canadian legislation, but has been used in practice in CCAA-based restructurings for some time (McMillan LLP, 2009).

However in the case of CCAA, the provision and structure of DIP financing generally reaches the court approval unchallenged as the process to agree on the terms of DIP financing is resolved through intense negotiations amongst the strategic stakeholders

prior to the commencement of CCAA proceedings (Gaur, 2012). The courts do not tend to intervene in DIP financing proceedings unless the terms are controversial, e.g. where the DIP lender is provided with super-priority security against the objections of existing creditors (Gaur, 2012). The securing of PPF is required upfront due to the fact that as soon as the company makes a CCAA filing, existing lenders and creditors tend to terminate financing facilities or change the terms of their payments (Gaur, 2012). It also provides confidence to the existing creditors regarding the fortunes of the company in distress.

The Canadian courts follow a “balance of prejudices” test regarding all creditors for the decision on authorising new financing (Gaur, 2012). This entails several enumerated criteria that need to be met before the authorisation of DIP financing takes place (McMillan LLP, 2009). This approach has been criticised for its vagueness (Gaur, 2012) and does not closely follow the concept of “adequate protection” found in the US Bankruptcy Code (McMillan LLP, 2009).

In terms of priority rankings, the Canadian law stipulates the following: (Rogers, 2012, p. 15)

- In terms of Section 136 of BIA Proceedings the following scheme of priorities are laid out in the following order:
  - “in the case of a deceased bankrupt, the reasonable funeral and testamentary expenses;
  - the costs of administration;
  - the levy payable under section 147 of the BIA to the Superintendent of Bankruptcy;
  - wages for services rendered to the bankrupt during six months immediately preceding the bankruptcy to a maximum of \$2,000 per person;
  - municipal taxes for two years immediately preceding the bankruptcy, not exceeding the value of the interest of the bankrupt in the property in question;
  - to landlords for arrears of rent for a period of three months immediately preceding the bankruptcy and accelerated rent for a period not exceeding three months following the bankruptcy, if called for under the lease, subject to a limit being the value of the property of the bankrupt on the premises under lease;
  - costs incurred by a creditor for asset seizure underway at the date of bankruptcy, but only to the extent of the value of the property eligible thereunder; and

- other claims for statutory deductions.”
- In CCAA Proceedings it is generally the responsibility of the courts to determine the relative rank of charges (McMillan LLP, 2009).

## **2.5.6 Australia**

### **a) General Overview**

The Australian bankruptcy legislation is governed by the Bankruptcy Act of 1966, where only individuals can become bankrupt (i.e. personal insolvency law). Insolvent companies go into insolvency or administration, and they are overseen by Chapter 5 of the Australian Companies Act (Corporate Law Reform Act 1992, now replaced by the Corporations Act 2001).

The Corporations Act makes provision for three formal arrangements where the focus is on rescue of a business rather than liquidation: (Australian Government, 2005)

- A scheme of arrangement;
- Receivership / Official Management; and
- Voluntary Administration.

The Australian law establishes a system of voluntary administration (“VA”) agreed upon by a ‘creditor pool’, whereby administrators are appointed by a resolution of the board of the company (Australian Government, 2005). The objective is to allow the business to continue in existence, or otherwise create a better return than if the company was liquidated. The appointment of the “administrator” (not required through court filing but can also be done through a simple appointment in writing) will impose an immediate moratorium that will last 28 days (Australian Government, 2005). The moratorium may be extended to 35 days or more with approval of the Court (Australian Government, 2005). A first meeting of creditors will be called within 8 business days of the appointment, to determine whether a committee of creditors should be appointed to liaise with the administrator. Following this the administrator must prepare a rescue plan containing recommendations as to whether the company should be returned to the control of the directors, wound up or execute a deed of company arrangement (Australian Government, 2005).

VA is available to any company, even if they are not currently insolvent but may be in the future (Australian Government, 2005). This enables directors to proactively implement business rescue so that adequate time is available for rescue actions. It is

striking that when comparing the rescue provisions in Australia, that they are almost identical to those in South Africa.

b) Financing a business in distress

There is little or no mention made in the Australian Act about the financing of business who have filed for bankruptcy. Therefore any additional liquidity requirements must be met by funding from existing creditors and lenders.

**2.5.7 Conclusion**

In summary the provisions of PCF can be compared with the other countries that were discussed:

**Table 2: Comparison of PCF in USA, UK, Canada, Australia and South Africa**

	USA	UK	CAN	AUS	RSA
<b>Philosophy</b>	Debtor friendly	Creditor friendly	Debtor friendly	Debtor friendly	Debtor friendly
<b>Rescue official</b>	Debtor-in-possession	Administrator	Trustee / Monitor	Administrator	Business rescue practitioner
<b>Concept of PCF exists?</b>	Yes, referred to as DIP Financing	No specific mention	Informally adopted DIP Financing with application of Balances of Prejudices Test	No specific mention	Yes
<b>PCF Priority</b>	Super-priority status after secured claims	N/A	Super-priority status ahead of other creditors including pre-filing bank lenders	N/A	Super-priority after BRPs remuneration and costs, and costs of BRP proceedings

From Table 2, it is generally accepted that there are limited guidelines and pre-requisites for PCF, therefore these will be further explored during the research conducted. The main input in this area is that of the USA with their DIP financing concept, from which important lessons can be learnt for South Africa.

## **2.6 The status quo on PCF in South Africa**

### **2.6.1 Introduction**

The international business rescue law landscape has been discussed, and the focus now moves to the current status on PCF in South Africa. As previously mentioned, the SA business rescue provisions are governed by the Companies Act 71 of 2008, which was amended and enacted in May 2011. This amendment intended to change the SA business rescue industry from a creditor-friendly to a debtor-friendly system.

A portion of the inclusive consultation process in the Act is a moratorium period where liquidation and legal proceedings are halted against the company. The outcomes that the appointed business rescue practitioner should focus on are firstly the rescue of the company and then a better return for the creditors or shareholders than would result from the immediate liquidation of the company.

More specifically, Chapter 6 and Section 135 of the Companies Act 61, 1973 deals with PCF (detailed provisions in **Appendix 2**). This section of the Act explains that PCF may be secured and such funding will be paid in a specific order of preference, as explained in Chapter 2.2 of this research report. These rankings are very important to companies who are experiencing cash flow distress in their business, as it will assist them in obtaining additional debt, by providing lenders with an incentive based on a higher priority ranking. However, accessing finance remains extremely difficult for companies in financial distress.

### **2.6.2 Background and history**

Before the current business rescue provisions were implemented in the SA Companies Act, the previous SA Companies Act and Insolvency Act provided very little protection to distressed businesses. As a result of this many businesses that could trade out of their difficulty could not negotiate with their creditors, and would ultimately end up in liquidation.

The process was previously governed in terms of Section 311 (Companies Act, Act 61 of 1973), which required a compromise proposed to entrepreneurs as an alternative “source of turnaround” and where a company may enter into a compromise with its creditors to arrange debt restructuring. This process is court-driven where both the creditors and the court must sanction the eventual compromise, and can be an expensive procedure to implement.

The above formal turnaround options (including section 427 of the “old” Companies Act) are not desirable due to the various negativities and high costs, and entrepreneurs used to prefer a more informal approach. However with the new business rescue legislation the formal process favours the distressed organisation and should encourage companies to embrace the formal process.

### **2.6.3 Current context for Business rescue Financing in SA**

As the new business rescue regulations only came into effect in May 2011, it is the dawn period in terms of evaluating the impact and effectiveness of post-commencement finance. Inasmuch, traditional funding options (particularly loan funding) for distressed businesses are limited and difficult to obtain because existing lenders are attempting to manage their existing risk exposure and do not want to risk more than they have already invested. Furthermore, if additional funds are advanced, the traditional lenders would require unencumbered assets or surety, which are often not available to a business once it has moved into financial distress.

This is further exacerbated by the impact of increasing lack of access to financing of businesses in distress as a result of the global financial crisis. In a study performed by Vriesendorp & Gramatikov (2010) focusing on the impact of the financial crisis on corporate rescue, their findings indicated that 84.7% of insolvency practitioners specify that it is more difficult to obtain financial facilities to rescue businesses in distress. This is true regardless of the type of legal system or insolvency regime used in a specific country. Some of the main reasons for this was found to be: i.e. the objective decrease of the amount of liquid financing available due to environmental factors (e.g. closing of hedge funds etc.); as well as the change to more restrictive banking regulations and policies both locally and internationally (e.g. Basel II Framework), as well as expectations to be more prudent (Vriesendorp & Gramatikov, 2010).

With the advent of the regulations around PCF, options to obtain new investment and distress funding have been released. A significant consideration for any investor is to receive a return on their investment; therefore opportunities for private equity firms to

intervene are pronounced. However, the private equity market in South Africa is very underdeveloped and needs to be supported in terms of creating and stimulating demand for distressed debt.

Interestingly, the experience in other countries expresses that PCF is often more profitable than traditional sources of finance. There is a higher risk attached to PCF, as it demands a higher reward and premium for the lender, and it has a higher status in terms of payment and protection of the debt in terms of the law (United States of America, 2002).

As can be seen from the above review and as a result of the recent implementation of the Act in South Africa, there is little to no literature available on PCF, and therefore little guidance on the current extent thereof. Identifying key prerequisites for PCF is therefore critical in order to increase the occurrence thereof.

## **2.7 Prerequisites for successful PCF**

In reviewing the literature, a few important prerequisites were identified for the successful advancing of PCF. These are explored below.

Brunner & Krahn (2001) performed a study to explore the impact of pooling of creditors of a distressed organisation, on the success of the company. They stated that multiple lenders reduce the incentive for a firm to default, but also have the risk of a lower expected pay-off in a liquidation situation. This type of debt is more challenging to renegotiate, and in some cases is even non-negotiable as the lenders have increased bargaining power when there are multiple lenders (Brunner & Krahn, 2001).

When the coordinated group of lenders (“bank pools”) is small, the likelihood of a successful turnaround is higher than if there were many lenders in the bank pool, as it also extends the time needed to resolve the distress (Brunner & Krahn, 2001). Brunner & Krahn (2001) also stated that multiple lenders are a powerful instrument to avoid hold-up, and that financial flexibility by a relationship lender should be weighed against the monopoly bargaining power of individual lenders. Therefore it is evident that the ideal size of the pools is often situation or context specific, and should be carefully balanced between the two opposite ends.

Lastly, the authors explained that the reason that there are so few workout activities in a firm once they have commenced bankruptcy is because bank pool arrangements are already commonly used earlier in the process of distress (Brunner & Krahn, 2001).

This may explain the reason why lenders are hesitant to invest later in the timeline of financial distress, as they have likely instituted all serious workout attempts well before the formal process of bankruptcy has commenced.

Tsuruta & Xu (2007) suggested that firms that are in financial distress that have more bank debt than trade credit tend to survive longer than their peers with higher trade credit than bank debt. One of the main reasons for this is that trade creditors are far more dispersed than banks, which tend to be more concentrated.

Beck, Demirguc-Kunt, Laeven, & Maksimovic (2006) found that the crucial attributes that predict whether a firm will face financing obstacles are: age, size and ownership. Their findings stated that younger, smaller, domestic firms experience more obstacles than their older, larger and foreign-owned peers. Interestingly the authors also considered country characteristics' impact on a firm's financing obstacles, which resulted in their finding that firms have lower financing obstacles in countries where there is a higher level of financial intermediary development, more liquid stock markets, more efficient stock markets, more efficient legal systems and a higher GDP per capita (Beck *et al.*, 2006). The most important variable however is the overall institutional development of a country (Beck *et al.*, 2006).

When banks enforce operational measures on firms during their restructuring, it results in higher success rates of the turnaround efforts (Couwenberg & de Jong, 2006). A further critical success factor outlined by Adiecha (2012) is that of cooperation and communication between lenders and borrowers, especially if the borrower is financially distressed. He stated that often increased reporting demands from lenders are placed on the distressed borrower, at a time when they are entangled in other problems in the business (Adiecha, 2012). A breakdown in communication during this time often amplifies the current problems, resulting in uncooperative and strained relationships at the worst possible time (Adiecha, 2012). He advised that a good strategy to follow during this time is the three C's, namely clarity, credibility and consistency in communications and submissions to lenders (Adiecha, 2012).

Therefore as can be seen, there is very little literature available on the key success factors of PCF. This will be explored in this research study. A key part of identifying success factors is to understand the current financing landscape.

## 2.8 Exploring the financing landscape and mind-set of financiers

Taking into account the local and international guidelines as well as the prerequisites for success, it is still important to consider the current financing landscape, as well as explore the motivations of financiers to advance funding to the distressed organisation.

Businesses normally need a combination of capital and credit to finance their business operations which they can typically access via various sources of financing available from a multitude of financial and other institutions. These sources of finance can be split into five categories, i.e. 1) traditional sources (mainly internal resources through working capital), 2) ownership capital (mainly the shareholders capital in the business), 3) non-ownership capital (mainly from bankers and creditors), 4) venture capital (mainly development capital) and 5) duration (long term, medium term and short term sources based on their date of maturity) (Timimi, 2010).

Beck *et al.* (2006) stated that there is an underlying assumption that external finance is more costly than internal finance, as a result of asymmetric information and agency problems. However once the business is in financial distress it generally means that they do not have any further means of raising finance internally and therefore are forced to consider external sources of funding.

When a business is in distress, it has generally been observed that it becomes much more challenging to obtain access to finance, especially following the recent financial crisis. Interestingly Goldblatt (2012) stated that although financial institutions have received much bad press and blame recently for not wanting to make loans, it simply is not true. He stated that qualifying borrowers should have no problem accessing conventional finance, and that for those borrowers that do not qualify, alternate sources of financing are available (Goldblatt, 2012). There are multiple parties that can meet these needs, not only traditional financial institutions. Banks, trade creditors and suppliers of goods are amongst the most common providers of credit, but other alternative sources of financing include: asset-based loans, factoring lenders, purchase order financing, international accounts receivable, intellectual property loans mezzanine financing and hard money lenders (Goldblatt, 2012). Therefore the distressed business not only has the option to approach commercial banks and other financial institutions, but also private equity firms, venture capitalists and a few other non-traditional lenders.

In Brunner & Krahnén's (2001) study of German firms, they found that the firms generally tend to have multiple lenders and that explicit coordination between these lenders are common, particularly at the onset of financial distress of the firm. Brunner & Krahnén (2001) further stated that the debt seniority rules of insolvency legislation explain why lenders are jointly willing to invest new money in a distressed venture that is in the turnaround process.

### **2.8.1 Trade Creditors**

Tsuruta & Xu (2007) found that a distressed firm falls into bankruptcy more rapidly when it uses more trade credit (e.g. accounts payable) and the level of trade payables decreases sharply shortly before bankruptcy. This is largely attributable to coordination failure between many dispersed creditors and suppliers, who can withdraw their funding or refuse supply of goods, quicker than banks, as their loans are unsecured (Tsuruta & Xu, 2007). Because they have more to lose when a firm goes bankrupt they generally tend to immediately “refuse to extend credit to financially distressed firms” (Tsuruta & Xu, 2007, p3).

Suppliers of goods and services, often also either reduce the terms of their payment or sometimes stop supply altogether (Lin *et al.*, 2008).

### **2.8.2 Commercial Banks**

Couwenberg & de Jong (2006) found in their study of firms in the Netherlands, that even though banks seldom make concessions or are overly generous, they are not ‘lazy’ in their efforts to assist firms in distress / failing firms. In feasible situations, where they are more involved with certain companies, banks will often provide additional financing coupled with a tightening of conditions and increase in restrictive covenants (Couwenberg & de Jong, 2006).

The successful firms also often provide additional collateral which allow banks to take a more lenient approach towards these firms (Couwenberg & de Jong, 2006). They also found that in ‘soft’ / debtor-friendly systems, the formal procedure of reorganisation is required, compared to creditor-friendly systems, where this often takes place as an informal (private) reorganisation process in order to avoid the threat of liquidation (Couwenberg & de Jong, 2006). In creditor-orientated systems it is often crucial to the success of the renegotiation that an active bank provides additional capital, whereas in soft bankruptcy systems banks do not want to give in twice and therefore they will not

be as active (but rather, sluggish) as in harsher bankruptcy systems (Couwenberg & de Jong, 2006). Before they submit on their secured position, banks will often ask more concessions of other creditors (Couwenberg & de Jong, 2006).

In contrast, Lin, Lee, & Gibbs (2008) found that when a company finds itself in financial distress, the bankers and other lenders will generally become stricter with their credit terms and certainly less willing to advance any additional loans.

More recently, as a result of the global financial crisis, the study conducted by Vriesendorp & Gramatikov (2010) extends some interesting observations regarding the role of banks in financing businesses in rescue, and is broadly in agreement with Lin *et al* (2008). Some of the reasons stated why banks are not providing financing post the credit crunch, include: (Vriesendorp & Gramatikov, 2010, pp. 221-222)

- “Banks have become very shy – the acute risk aversion of banks.”
- “The capacity and willingness of bankers to understand the business of their clients.”
- “Bureaucracy attitudes of bankers towards the needs of the business.”
- “The banks have not been equipped to deal with the crisis.”
- “They insist on massive security which a client, who is already in distress, cannot provide.”

Interestingly some respondents believed that due to the fact that bankers did not identify the factors leading to the credit crunch timeously, they have become short-signed to the needs of their clients (Vriesendorp & Gramatikov, 2010). In contrast, Goldblatt (2012) stated that the current perception that banks do not want to lend is incorrect, and the lack of access to credit currently, is not a hurdle in the economy. They will not lend to merely everyone, only creditworthy companies, and their standards for obtaining a loan have become more stringent (Goldblatt, 2012).

### **2.8.3 Private Market Lenders / Finance Companies**

A remarkable lender in the financial lending industry is that of private finance companies who specialise in higher risk lending. These companies are all “nondepository financial institutions involved primarily in extending credit to businesses and consumers” (Carey, Post, & Sharpe, 1998, p. 848) and as they do not collect deposits they are not constrained by banking regulations. They have a different level

of specialisation from public commercial banks due to two main factors: (Carey *et al.*, 1998)

- Regulation: Bank regulators, who manage the risk of banks, limit banks' ability to serve high-risk borrowers.
- Reputation: A lender's reputation for reasonableness might be damaged if it frequently borrows to firms who end up in liquidation.

The above two factors explain why banks are often not interested in financing businesses in distress / high-risk businesses and why a particular specialisation has been unlocked for Private Finance Companies.

#### **2.8.4 Private Equity Firms**

Another important player in the financing landscape is Private Equity ("PE") firms. The Investopedia website defines PE as follows: (Investopedia, 2012b, p. 1)

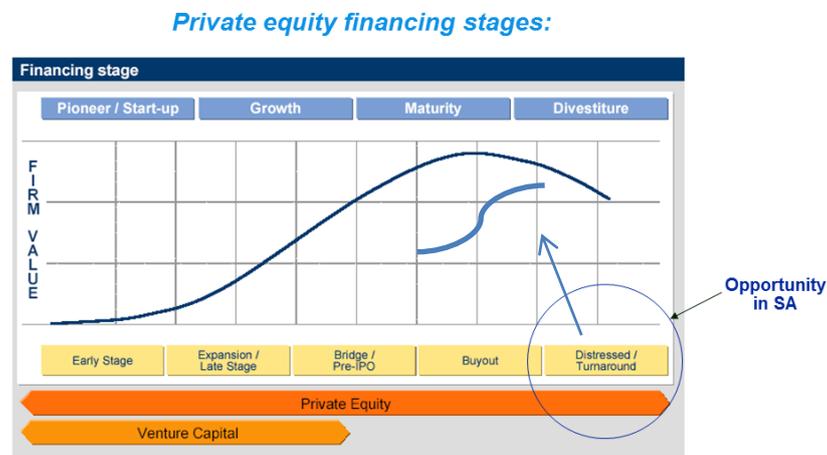
*Private Equity: "Equity capital that is not quoted on a public exchange. Private equity consists of investors and funds that make investments directly into private companies or conduct buyouts of public companies that result in a delisting of public equity. Capital for private equity is raised from retail and institutional investors, and can be used to fund new technologies, expand working capital within an owned company, make acquisitions, or to strengthen a balance sheet. The majority of private equity consists of institutional investors and accredited investors who can commit large sums of money for long periods of time. **Private equity investments often demand long holding periods to allow for a turnaround of a distressed company or a liquidity event such as an IPO or sale to a public company.***

Therefore PE firms play a large role in investing in firms that are in distress and require a turnaround. In fact, Cuny & Talmor (2007) proposed that where there has been an attempted turnaround, the success rate is highest when under private equity. Part of the reason for this could be that the PE firm invests into the organisation in the long term, and also becomes deeply entrenched in the organisation and its decision making. This often takes place in the form of a management buyout, third-party buyout or a change in management altogether (Cuny & Talmor, 2007). PE often improve operations, use more leverage and club deals, and ultimately act like a turnaround practitioner in a distressed firm.

Considering the difficulty described above concerning the challenges of obtaining loan finance for businesses in distress, PE firms should be the logical solution. The PE

industry abroad is well-developed in contrast to South Africa where it is very small and underdeveloped. Therefore there is a need for a stronger private equity industry in South Africa, which will hopefully be stimulated by the new debtor-friendly legislation in South Africa (van der Walt, 2006). This presents an opportunity for investment in distressed companies by PE firms in South Africa through assisting in a potential upturn in the lifecycle of a business. This can be seen in **Figure 6** where the different stages of PE financing are expanded on.

**Figure 6: Private Equity Financing Stages (van der Walt, 2006)**  
*New business rescue legislation will stimulate the market for distressed situation/turnaround investment*



### 2.8.5 Distressed Debt Financiers

Another form of financier that is particularly predominant in the USA, is the distressed debt financier/trader, or controversially referred to as “vulture investors”. The development of an active secondary market for trading in the financial claims of companies in financial distress has resulted in a number of participants entering this market. These include mainstream institutional investors, money managers, hedge funds and vultures (Gilson, 1995). Gilson (1995) also stated that historically the market for distressed debt has provided more opportunities than other corporate restructuring activities (Gilson, 1995).

Distressed lenders play a critical role in creating value in a restructuring situation, particularly for bank lenders, trade creditors and naturally the firm in distress (Gilson, 1995).

A vulture investor typically follows three types of strategies to obtain a positive return: (Gilson, 1995)

- Taking control of the business through an active management role (where they can influence how the firm's assets are deployed,
- Apply “bondmail” where the investor takes over other party's share of the investment in order to obtain more than a third of the claims, and therefore in turn blocking the reorganisation plan to obtain a higher recovery, , or
- Do nothing and follow a “buy-and-hold” strategy to exploit possible overreaction in the market.

The ability of a vulture investor to enforce the above strategy is a result of the “cram down” procedure available in certain rescue jurisdictions such as the USA and the UK . This procedure entails that a two-thirds majority of creditors can force reorganisation on a dissenting minority (United States of America, 2002). As long as the vulture investor obtains more than one third of the claims, he can prevent the reorganisation plan indefinitely.

There are naturally many risks in this form of investing, but these are highly firm-specific and generally legal and institutional in nature (Gilson, 1995). The successful investors generally apply three key qualities: (Gilson, 1995, p. 23)

- “A superior ability to value a firm's assets”
- “A superior negotiating and bargaining skill”
- Understanding of “the risks of investing in distressed situations”

Based on the above literature it is clear that there are mixed views as to the general appetite for lending to distressed businesses, dependent on the nature of company and the risk appetite of the lender.

## 2.9 Conclusion

It is evident from the literature that has been reviewed in this section that scientific literature on rescue (and even more so financing of business in distress) from developing countries such as South Africa is almost non-existent. This is understandable as generally rescue practitioners protect the intellectual property of their strategies as it often represents their underlying competitive advantage. However guidance does exist in the international arena that could be utilised to inform best practice application in a local context.

In summary, this chapter discussed the literature around the international best practice in terms of PCF, contrasted that to the limited knowledge in the local South African context, attempted to identify clear phases of PCF, discovered some of the impact of the stage of decline on the success of the financing arrangement, identified some prerequisites for successful PCF as well as performed an initial exploration of the current landscape of financing available to distressed businesses. As mentioned, there is limited literature available to substantiate the current nature and extent of PCF in South Africa, as well as provide evidence to the themes mentioned above. Therefore these six themes will form the basis of the research propositions created in Chapter 3 and will be utilised as a tool for guiding for the data collection and analysis process, which will be explained in Chapter 4.

## CHAPTER 3 RESEARCH PROPOSITIONS

The purpose of this research study is to explore the current state of PCF in business rescue in South Africa. The previous chapter discussed the available literature on PCF during which a few important themes surfaced. Chapter 3 ensures to emphasise these themes in the form of propositions that are tested in this research study. Accordingly, the following propositions draw on issues that have emerged from the literature review detailed in Chapter 2, supported (and protracted) by the motivation for the research as detailed in Chapter 1, which this research study will attempt to investigate.

- **Proposition #1:** Internationally there are clear prescriptives for post-commencement finance.
- **Proposition #2:** The extent of post-commencement finance for business rescue in South Africa is non-existent.
- **Proposition #3:** Post-commencement finance has clear phases.
- **Proposition #4:** Prerequisites for successful post-commencement finance can be identified.
- **Proposition #5:** The reasons for lenders' (banks, private equity firms, other institutions etc.) disinterest in post-commencement finance are clear.
- **Proposition #6:** Defined stages of decline can be identified, which impact the success of the business rescue proceedings.

## CHAPTER 4 RESEARCH METHODOLOGY & DESIGN

### 4.1 Introduction

The previous chapter explained the research propositions that were tested in this research study. This purpose of this chapter is to describe the research methodology that was used to test the propositions outlined in Chapter 3, as well as to gather and analyse the research data in this study.

Yin (2003) provided five major research strategies which one could follow depending on what the researcher hopes to achieve with a specific study. There are three conditions that are used to assist the researcher in deciding which strategy to choose: (Yin, 2003)

- The type of research question,
- The extent of control a researcher has over behavioural events and
- The degree of focus on contemporary as opposed to historical events.

**These are described in Table 3 below: Table 3: Relevant Situations for Different Research Strategies (Yin, 2003, p5)**

Strategy	Form of Research Question	Requires Control of Behavioural Events?	Focuses on Contemporary Events?
Experiment	How, why?	Yes	Yes
Survey	Who, what, where, how many, how much?	No	Yes
Archival analysis	Who, what, where, how many, how much?	No	Yes/No
History	How, why?	No	No
Case Study	How, why?	No	Yes

Therefore, as guided by Yin's (2003) strategic choices and three conditions, qualitative research was chosen as the appropriate strategy for this study, utilising a combination of surveys and case study concepts.

Furthermore, Leedy & Ormrod (2001) explained that researchers normally adopt qualitative research when their purpose is to better understand complex situations, which results in their work being exploratory. They also stated that researchers may often use their findings to build up theory. Lastly, qualitative research is often used for the following purposes: description, interpretation, verification and evaluation (Leedy & Ormrod, 2001).

This research study therefore follows a qualitative method as the emphasis is on exploring an area where little theory exists, aimed at seeking meaning rather than measurement, and aims to build on the lack of theory that currently exists in this research area.

## **4.2 Research Design**

### **4.2.1 Research approach**

The research approach is exploratory (including confirmatory and descriptive elements), and qualitative in nature. Exploratory studies are ideal in seeking to obtain new insights or new demands on a topic that are not well understood by the researcher (Saunders & Lewis, 2012). It often has the aim of trying to explain and describe the phenomena from the “participant’s point of view” (Leedy & Ormrod, 2001, p101).

Leedy & Ormrod (2001, p101) explained that the process that is followed by researchers is normally initiated with “general research questions..., collect an extensive amount of verbal data from a small number of participants, organise them into some form that gives them coherence, and use verbal descriptors to portray the situation they have studied”.

A process of deduction was used to test the theoretical propositions identified above, and the stated research strategy designed to do this was utilised (Saunders & Lewis, 2012). The approach focused on formulating propositions derived from the theory base, then testing and modifying those propositions through semi-structured interviews. The propositions provided a conceptual framework and guided data collection and analysis. They were tested, verified and modified against the reality that emerged from the data, leading to conclusions. Content, narrative and comparative analysis was then utilised to make conclusions.

This form of analysis identifies and explains the embedded experiences of specialist rescue practitioners with extensive experience in rescue and turnaround, through

expert interviews. With **Table 4** as a framework, this study focuses on describing the status of post-commencement financing in business rescue in South Africa.

**Table 4 Research design components based on the design description of Yin (2003, p21).**

<b>Component</b>	<b>Description</b>
<i>Research question or problem</i>	What is the status (i.e. nature and extent) of post-commencement finance requirements in South Africa?
<i>Propositions*</i>	<ul style="list-style-type: none"> <li>• Proposition #1: Internationally there are clear prescriptives for post-commencement finance.</li> <li>• Proposition #2: The extent of post-commencement finance for Business rescue in South Africa is non-existent.</li> <li>• Proposition #3: Post-commencement finance has clear phases.</li> <li>• Proposition #4: Prerequisites for successful post-commencement finance can be identified.</li> <li>• Proposition #5: The reasons for lenders' disinterest in post-commencement finance are clear.</li> <li>• Proposition #6: Defined stages of decline/financial distress can be identified, which impact/determine the success of the business rescue proceedings.</li> </ul>
<i>Unit of investigation</i>	Primary – Post-commencement finance: Issues & Status Secondary – Post-commencement finance: Elements
<i>Unit of analysis</i>	Specialist business rescue and turnaround practitioners (senior BRPs) and financiers
<i>Logic linking the data to the propositions</i>	Specialist rescue practitioners have to assist the business in rescue proceedings with obtaining finance. Having a good understanding of the current landscape, best practice and appropriate sources available, will assist in their decision making in this regard.
<i>Criteria for interpreting the findings</i>	Success factors, issues and status of financing Elements of financing Processes that subjects use to decide on appropriate financing
* <i>the propositions were set to structure the research process and support the research question.</i>	

The following section explains the rationale for the proposed method:

As mentioned, the research was exploratory, with confirmatory and descriptive elements, and aimed to understand a new phenomenon—in this case, post-commencement financing for business rescue in South Africa—from the perspectives of those who were interviewed in the study (Saunders & Lewis, 2012). Qualitative research is recommended when a researcher aims to interpret a phenomenon in a specific context rather than simply establishing a link between two variables (Leedy & Ormrod, 2001).

As noted in the literature review, the theory base for post-commencement financing (and international equivalents) has emerged from a developed world paradigm, and little research has been done in a South African or developing market, due to the short time span since the adoption of the legislation. A qualitative, largely exploratory approach was therefore considered most appropriate for this research study, given that the study aimed to contribute to building theory related to post-commencement financing in distressed businesses, which operate in a South African context.

According to Saunders & Lewis (2012, p 110), the usual process to conduct exploratory research is: 1) “searching the academic literature, 2) interviewing ‘experts’ in the subject, and 3) conducting interviews”. Therefore propositions were derived from the business rescue theory base, a process that was covered in detail in Chapter 2 and Chapter 3 of this research study.

The method of conducting in-depth expert interviews was selected to obtain data, as interviews are well suited to exploratory studies using qualitative methods (Saunders & Lewis, 2012). Objective secondary data on rescue was difficult to obtain due to the newness of the subject area and legislation, as well as the subjectivity of its application in practice. Therefore it was decided that interviews of the perceptions and realities experienced by experienced rescue professionals were chosen as the most viable option to gather data. Semi-structured interviews were used to collect the data, through predetermined questions with a set of themes, which vary in order as the interview progressed and the researcher deemed appropriate (Saunders & Lewis, 2012). Lastly, Marshall & Rossman (2006) shared a very useful information in the form of a table to further clarify which type of strategy should be chosen when performing qualitative research; refer to **Table 5** below:

**Table 5 Qualitative genre and overall strategy (Marshall & Rossman, 2006)**

Genre	Main strategy	The focus of enquiry
Individual lived experience	In-depth interviews	Individuals
Society and culture	Case study	Groups or organisations
Language and communication	Micro-analysis and text analysis	Speech events and interactions

Therefore, due to the fact that the individual lived experience of the business rescue and financing experts is a requirement, in-depth interviews were the most appropriate method of conducting research.

It is important to note that while qualitative findings can be replicated, and sometimes be generalised to theory (Yin, 2003), they cannot be inferred across the entire

population given the small sample size. Saunders & Lewis (2012) warned that for this reason, the research should heed drawing definitive conclusions from the findings.

#### **4.2.2 Research Process**

The research study took the form of a two-phase qualitative study, where a thorough review of the literature surfaced propositions which were tested.

**Phase one** involved a detailed review of the literature to build an understanding of concepts relating to the study and to provide justification for the research topic. Specifically, the following data was sourced: surfacing the international best practice for post-commencement finance, the different phases of financing required, the related success factors and reasons for lenders' disinterest in financing distressed businesses. This process was discussed comprehensively in Chapter 2, and the results were used to formulate the propositions listed in Chapter 3. These initial propositions were then tested, through semi-structured interviews, as discussed below. The propositions informed the interview guide used for data collection, and were used to guide analysis.

**Phase two** involved a series of face-to-face semi-structured expert interviews with 18 experts in the field of business rescue, in order to explore the propositions submitted in Chapter 3.

#### **4.2.3 Expert interviews as a research strategy**

An expert is described as a "person who has a high degree of skill and knowledge in a certain domain, field or industry due to long-time experience and has status, power-to-act and decision-making opportunities based on these skills and knowledge" (Belting, 2008, p. 2). The researcher used interviews to extract the phenomena within a real world context where the boundaries between phenomena and context are not clearly evident. Yin (2003) suggested that the uniqueness of individual experiences is a sufficient rationale for describing that contextual variation.

Belting (2008, p.2) explained that the intent of expert interviews is to "reconstruct the knowledge of experts". The information obtained in an interview is largely a description and interpretation of the interviewees' words, experiences and thoughts. The main aim of the interviewer is to understand the topic in question from the the interviewee's perspective. The reasoning the researcher used was mostly inductive to explore the subjects' understanding, experiences, interpretations and knowledge building for the different experiences they reported on.

#### **4.2.4 Research setting and background**

The researcher interviewed 18 specialists purposively selected to participate in this study. Industry specialists with practical experience were identified and these specialists were selected to participate in the case study. During this period the subjects were requested to reflect on their past business rescues during the interview as well as to report on their understanding of the current South African PCF conditions.

The estimated time allocated for each interview was 60 minutes. Subjects were also reassured that there would be total anonymity and that the results would only be used for the research project.

### **4.3 Unit of Analysis**

The primary unit of investigation is Post-commencement finance: Issues & Status and the secondary unit of investigation is Post-commencement finance: Elements.

The unit of analysis for the study is specialist business rescue and turnaround practitioners (Business rescue practitioners) as well as experts in different financing institutions.

The list of experts that were interviewed can be found in **Appendix 3**.

### **4.4 Population**

The population of the research study included all South African experts in the field of business rescue and turnaround who possess the necessary experience and knowledge in the field. There were approximately 84 accredited Practitioners as of March 2012, according to CIPC (CIPC, 2012). This number did not include individuals in organisations who advance money to businesses in distress, as no sample frame existed for them. These experts have been involved in a consulting or advisory capacity in the field of business rescue and are therefore well placed to comment on the current status of PCF in South Africa.

Phase Two involved conducting in-depth interviews with these experts. Given the nature of the research problem as well as the industry, the population is small and comprises of individuals in the industries and professions mentioned above.

## 4.5 Sampling method and size

### 4.5.1 *Sampling technique*

Due to the qualitative nature of the topic, as well as the fact that the researcher had a complete list of the entire BRP population but not one for the financier population, non-probability sampling techniques were selected (Saunders & Lewis, 2012). Due to the fact that the sampling size could not be randomly selected, the researcher was unable to know the probability of each member being selected (Saunders & Lewis, 2012).

Convenience sampling is sampling achieved by obtaining units of people who are conveniently available (Saunders & Lewis, 2012), whereas judgement sampling (as a sub-set of convenience, with purposive sampling) is a non-probability technique in which an experienced individual selects the sample based upon some appropriate characteristics / criterion of the same matter. In this case the criterion was that the interview subjects were expected to be experienced and qualified to provide informed opinions and detailed information regarding the research problem. On the basis of the convenience offered by proximity, the respondents were selected from South Africa.

Qualitative samples most frequently tend to be purposive, rather than random, which requires the researcher to use his / her judgement to select who would be the best sample respondent to answer the research question (Saunders & Lewis, 2012).

Convenience purposive sampling combined with judgement sampling was used since it makes provision for practical considerations. Respondents were identified through the researcher's and supervisor's own contacts and purposively sampled based on accessibility and experience. It also allowed freedom to choose individuals who are well regarded in terms of their knowledge of the research area. In some cases, the researcher already had access to the interviewees i.e. they were convenience samples (Marshall & Rossman, 2006).

Guided by the aim of engaging business rescue professionals who had led, or been part of, a team leading turnaround situations, the researcher applied a screening procedure to be certain that the identified experts fitted the intention of the research.

#### **4.5.2 Criteria for Selection of Respondents from the Population**

Saunders & Lewis (2012), stated that when purposive sampling is used, the criteria used for selecting the sample needs to be explained, together with the reasons for the choice and the underlying premise. The criteria used to select respondents purposively from the population were based on the following qualifiers:

##### Business rescue practitioners:

- a. They had all been involved, directly or indirectly (formally or informally) in turning around a distressed organisation or business unit (having led or been a member of a turnaround team);
- b. Having worked in a business venture for more than three years, to fully appreciate the dynamics and see the interactions / results of such turnarounds; i.e. extensive rescue experience.
- c. They are well-seasoned and generally experienced business people, in order to extract knowledge and wisdom from the “grey beards” of industry; and
- d. Experience as a Senior Business rescue practitioner.

##### Financing Institutions:

- a. Senior corporate rescue experience
- b. Senior decision making power in the organisation;
- c. They had all been involved, directly or indirectly (formally or informally) in turning around a distressed organisation or business unit (having led or been a member of a turnaround team); and
- d. They are well-seasoned and generally experienced business people, in order to extract knowledge and wisdom from the “grey beards” of industry.

The researcher' approached the subjects individually requesting participation. The experts (respondents) met all the above criteria, having driven turnaround situations in their past and present work situations, and being recognised by reputation in the industry.

The interviews were guided by the Protocol or Interview Guide (See **Appendix 4**). Furthermore, the researcher completed transcripts for each of the discussions. Both the full recordings as well as transcripts are available.

### **4.5.3 Sample size**

For this research the sample size was 18, consisting of ten senior business rescue practitioners and eight experts in different financing institutions. This is considered to be a relatively small sample size resulting from the nature of the industry, the research problem, and the research design.

The sample size was deemed to be more than sufficient based on the benchmark of six to twelve interviews being the ideal sample size for qualitative research, provided by (Guest, Bunce, & Johnson, 2006). A higher sample size was selected as two distinct population groups were chosen to be interviewed, and at times contrasted.

The possible factors that may impact the sample size are the availability and interest of the chosen respondents.

## **4.6 Data collection process**

### **4.6.1 Overview of the process**

Whilst it is technically possible to separate the data collection and data analysis phases in a qualitative study it is vital to remember that the collection and analysis phases need to take place iteratively in order to obtain deeper levels of understanding as the process progresses.

The data collection and analysis process that was followed in order to achieve the required quality of results was as follows (Leedy & Ormrod (2001), Marshall & Rossman (2006), Yin, (2003)):-

- Conducted first expert interview.
- Transcribed interview through tape recording.
- Reflected on respondents' emotional states, body language, language used.
- Captured researcher notes, attempted to developing common themes using the words that the respondent used.
- Synthesised and organised researcher notes according to codes and categories determined by propositions. Noted any new themes emerging, and adjusted interview guide accordingly to allow for further exploration of the new themes.
- Received an overall sense of the data, and commenced with finding meaning in the data.

- Once all interviews were completed, conducted content and narrative analysis, identified which themes and patterns were most prominent and noted particularly interesting individual findings.
- Repeated the above steps until a point of theoretical saturation had been reached where new themes or insights uncommon, and then performed intensive analysis on the captured data (final content analysis).
- Synthesised the data into tables or propositions, with the analysis being based on rigorous analysis.

The researcher solicited interviews by sending personalised, detailed, but concise e-mails directly to the prospective interviewee. The e-mail was followed up by means of a telephone call, whereby the date and venue of the ensuing interview would be established. The researcher then sent a pre-interview information pack to each prospective interviewee that consisted of:

- A formal and personalised letter of introduction, which included an undertaking of confidentiality, a written confirmation of the appointment and an undertaking to provide the respondent with a copy of the integrated research project report.
- An independent letter from the Gordon Institute of Business Science, confirming that the research and the researcher are legitimate.
- A pre-interview guideline listing the questions that the researcher would ultimately like to have answered by the time the interview had been concluded (or as near as possible) was provided upon request. The guideline was not intended to be used in a mechanistic question and answer session, but was rather intended to be a tool that would enable the respondent to think about some of the issues that were destined for discussion during the in-depth “conversation”.

The researcher received assistance from Gordon Institute of Business Science (“GIBS”) in the form of a confirmation of affiliation with the University on an official letterhead that accompanied interview requests and served to provide credibility for the research study.

The pre-interview information pack was mailed to the respondent at least three days prior to the interview. The pre-interview information pack can be viewed in **Appendix 5** and the consent letter is attached as **Appendix 6**. Immediately after the interview a post-interview “thank you” letter was emailed to the respondent; this can be viewed as **Appendix 7**.

#### 4.6.2 Interview guide design

The interview guide design was based on information gathered from the literature review (Chapter 2) and the propositions developed in Chapter 3. The final interview guide posed six questions, all of which were open-ended (see Appendix 4).

Table 6 expresses how each of the questions relates to the individual propositions.

**Table 6: How the research questions relate to the propositions**

Propositions	Questions
Proposition #1: Internationally there are clear prescriptives for post-commencement finance.	<i>What are the key prescriptives internationally around post-commencement finance?</i>
Proposition #2: The extent of post-commencement finance for Business rescue in South Africa is non-existent.	<i>In your experience, what is the current nature and extent of post-commencement finance for business rescue in South Africa?</i>
Proposition #3: Post-commencement finance has clear phases.	<i>What are the different phases of post-commencement finance that a business in distress needs?</i>
Proposition #4: Prerequisites for successful post-commencement finance can be identified.	<i>Are there known prerequisites for successful post-commencement finance that you have obtained through your experience? If yes, what are they?</i>
Proposition #5: The reasons for lenders' (Venture Capitalists, banks, other institutions etc.) disinterest in post-commencement finance are clear.	<i>What would you describe as the reasons for lenders' (banks, private equity firms, other institutions etc.) disinterest in post-commencement finance?</i>
Proposition #6: Defined stages (or situations) of decline/financial distress can be identified, which impact/determine the success of the business rescue proceedings.	<i>What are the stages (or situations) of decline/financial distress and how do they impact/determine the success of the business rescue proceedings?</i>

#### 4.6.3 Data Collection

Semi-structured interviews were used for the data collection in phase two of the study. Yin (2003) suggested that interviews are one of the most important sources of case study information and that interviews appear to be guided conversations rather than structured queries. This type of interview enables the interviewer to

probe with a view to elucidating any vague responses, or to request for elaboration when incomplete responses are provided. This level of freedom makes semi-structured interviews particularly applicable to the nature of this research study. Semi-structured interviews, combined with observations made during the interviews, were the primary methods used to gather data.

Each interview lasted for approximately 60 to 90 minutes. An interview guide was prepared, based on the propositions that emerge from phase one (see **Appendix 4** for interview guide). All interviews were recorded with a voice recorder, and the recordings were later transcribed into written documents. Each transcription took an average of four hours to complete and a further four hours to analyse.

A minimal response technique was used, along with some paraphrasing, summarising and clarifying techniques that allowed the researcher to test her own understanding and to sharpen the focus of vague comments. Interviews began with an invitation to 'tell the story' of the business rescue proceedings. The phenomena the researcher investigated involved the subjects' perspectives; their thinking, experiences and decision-making as well as the real life cases of distressed ventures, with their specific contexts. Guion (2006) offers several crucial characteristics of in-depth interviews. The researcher adhered to the following guidelines:

- a) Questions were open-ended, ensuring that the respondents could not simply answer by saying yes or no, but that they could expand on the topic.
- b) The format of the interview was semi-structured with some pre-planned questions, while allowing for a natural free flow of conversation and questions.
- c) The interviewer sought understanding and interpretation of what was heard. The interviewer searched for a deeper understanding and clarity from the respondent throughout the interview.
- d) The researcher recorded responses with an audiotape and note pad.

The researcher adhered to the principles of conducting productive interviews by Leedy & Ormrod (2001). Special attention was paid to ensuring that sufficient time was spent building rapport as well as being a good listener and not putting words in their mouth.

## 4.7 Data Management

The management of the data is of the utmost importance as it provides the content and evidence for the entire research study. Therefore numerous back-ups of the data were made, including data that was stored online virtually in a cloud, on the local computer of the researcher and on an external hard drive.

The redundancy of numerous storage facilities ensures that the data from which the entire research study is based is not lost or that integrity is compromised and will be available for retrieval within the future should the research data ever be required.

## 4.8 Data Analysis

Data analysis and interpretation are an important part of the research process. Given that a large proportion of the data being collected was qualitative in nature; considerable use was made of inductive reasoning during the analysis and interpretation of the data. Qualitative researchers often discover certain findings and then draw inferences on the larger phenomena, often referred to as inductive reasoning (Leedy & Ormrod, 2001).

Data analysis in qualitative research can be likened to a metamorphosis where a researcher retreats with the data, applies his / her analytic abilities and finally emerges with the findings.

A combination of content and narrative analysis was used to test and refine the theory-based propositions (Yin, 2003). While comparative analysis as advocated by Yin (2003) is usually applied to case studies, semi-structured interviews were used for this study, given time and resource constraints.

Data analysis consists of breaking down the information gathered, in which convergent evidence is sought regarding the facts and conclusions from various experts. According to Yin (2003), data analysis incorporates records (evidence). These six sources of evidence are (Yin, 2003): documentation, archival records, interviews, direct observations, participant observation and physical artefacts. The researcher used three of these sources, namely: interviews, direct observations and physical artefacts. This also included the actions, behaviour, attitudes and perceptions of the experts. Finally, having analysed the data and the convergent evidence, the researcher sought to confirm how and why a particular proposition was or was not demonstrated.

The interviews were transcribed and the transcripts were organised around themes emerging from the interviews. Furthermore, content analysis was used to analyse the data collected from the interviews. Content analysis measures the semantic content or the “what” of a message (Leedy & Ormrod, 2001). It also is the examination of contents in order to identify “patterns, themes or biases” (Leedy & Ormrod, 2001, p155). In order to generate categories and themes effectively, the following methods were used, as recommended by Marshall & Rossman (2006):

- Identification of salient themes.
- Identification of recurring ideas or language.
- Identification of patterns of belief that linked people and settings together.
- Each category/theme became a basket into which segments of text were placed.
- Categories needed to be internally consistent but distinct from one another (internal convergence and external divergence).
- The process was therefore an in-depth analysis: discovering patterns, themes and pedigrees.
- The aim was also to generate indigenous typologies created and expressed by participants.

A technological qualitative data analysis tool called Atlas.ti Data Analysis Software version 7.0 was used to organise, code, label and analyse the data into logical categories/constructs and themes and to index the different pieces of data for easy retrieval. Atlas.ti also coded the transcriptions into key themes, concepts, questions or ideas using an inductive approach in defining the categories of the codes. Further information regarding this software can be found at [www.atlasti.com](http://www.atlasti.com). The coding was utilised to build up conceptual frameworks based on common understanding/themes from the different respondent’s expert knowledge. Quotes were selected on the basis that they are representative of the themes discovered during the research process.

## 4.9 Data Validity & Reliability

Any research study should seek to ensure that its findings are both valid and reliable. Yin (2003) explains the concepts of the quality of empirical social research (designs), which explains that research work should be tested for relevance using four tests:

- **Construct validity:** *establishing correct operational measures for the concepts being studied* (Yin, 2003). This generally occurs during data collection. The

researcher used multiple sources of evidence, namely asking respondents (experts) whether they have faced turnaround situations where financing was required. This enabled the researcher to establish a chain of evidence. In order to improve construct validity, a consistency matrix was compiled, showing how constructs were measured. Furthermore it was achieved by attributing the correct cause and effect, therefore interpreting the results of the study correctly. This could also have been achieved by way of triangulation, by using multiple sources of data.

- **External validity:** *establishing the domain in which a study's findings can be generalised* (Yin, 2003). This generally occurs during research design. The theoretical discussion in Chapter 2 in this research study reinforced the external validity. The primary way that this study overcome external validity concerns was to undertake multiple interviews of multiple experts.
- **Reliability:** *demonstrating that the operations of a study—such as the data-collection procedures—can be repeated with the same results* (Yin, 2003). This generally occurs during data collection and the protocol/discussion guide addresses the reliability test. However, this should be read in the context of the research limitations outlined in the following section. Reliability was achieved in this study through triangulation, for instance by also having applied secondary data sources and verification.

It is up to the interviewer to ensure that the interviewee fully understands the question and context and builds good rapport with the interviewee to be able to extract the most honest and thorough answers throughout the interview process as possible. Errors that occur within qualitative research are often introduced by the researcher and are not easy to detect. Therefore it is important that the interviewer is highly aware of these potential errors and should build in measures to control error in their selection and interviewing procedures.

#### 4.10 Research Limitations

Due to the nature of this study, time constraints and various other potential limitations were identified. These include:

- The researcher/interviewer may misinterpret data or may substitute his/her own understanding for the reality of the respondent's response.

- There is a risk of interviewer bias where the interviewer's own bias may affect the respondent's information and the interviewer's may "lead"/influence the respondent.
- The risk of social desirability bias: bias in the responses of respondents (experts) caused by their desire—either conscious or unconscious—to gain prestige or to appear in a different social role.
- The relatively small sample of individuals interviewed carried the risk of the respondents being prone to provide answers in line with the researcher's expectations.
- A sample has been taken within a specific time period, thereby excluding all activity outside of this time frame i.e. all activity since May 2011 has been incorporated.
- Judgemental purposive sampling had to be used in Phase One in order to identify experts in the field.
- Only South African experts were selected as interviewees, therefore excluding any other potential international experts. At the time of conducting interviews these individuals were available in the greater Gauteng region and parts of the Western Cape; i.e. it was a sample of convenience subjected to a cross-sectional study at a specific point in time. The sample was not statistically representative of experienced business rescue practitioners in South Africa.
- As the sample is not representative of the population (universe), a non-probability sampling may result in a finding that is not representative of the population. Therefore, it would be inappropriate to project the research findings beyond the sample, without additional research.

Marshall and Rossman (2006) also listed some weaknesses and limitations of in-depth interviewing, as follows:

- It involves personal interaction and therefore cooperation is essential.
- Interviewees may be unwilling or uncomfortable with sharing all the information that the interviewer expects.
- The interviewer may not have the necessary skills to ask questions that evoke long narratives.
- The interviewee may have good reasons not to be truthful.
- In addition analysts-constructed typologies are generated. They are created by the researcher and grounded in the data but not necessarily used explicitly by the participants.

## **4.11 Confidentiality and Anonymity**

In order to maintain anonymity of the interviewees throughout the research process, the publication of this dissertation and any articles that may follow thereafter, the digital audio recordings of the interviews and the transcriptions thereof are kept confidential.

During the writing of the dissertation, confidentiality was ensured by restricting access to the data to as few people as possible and by ensuring that anyone who had access to this data was under legal obligation to keep such data confidential by means of a Non-Disclosure Agreement that was signed by such parties.

## **4.12 Conclusion**

The empirical data which had been collected via the interview process was analysed according to the methods discussed in this chapter to develop the necessary insight in answering the research propositions raised in Chapter 3. While the sample size was small, it was still effective in the discovery of insight into the structure, strategy, dynamics and culture of business rescue in the South African context as well as obtained primary data through exploratory qualitative research. The necessary insight had been obtained by industry experts with detailed knowledge that had provided a holistic perspective on the process of business rescue. The next chapter will present some of the data gathered during these depth interviews, specifically framed in the context of the research propositions outlined in Chapter 3.

## CHAPTER 5 RESEARCH RESULTS

### 5.1 Introduction

In Chapter 4, the methodology used to test the propositions outlined in Chapter 3, was explained. Therefore the results are presented in alignment with the propositions indicated in Chapter 3. This chapter presents the findings extracted from 18 expert interviews with business rescue practitioners and financiers working mainly in Gauteng and Western Cape, South Africa.

The layout of the chapter was informed by the propositions identified in Chapter 3. Therefore all results and findings were summarised for each hypothesis. These were directly correlated with the questions posed in the data collection tool. This chapter commences with a brief description of the sample and outlines the process of data analysis that was followed. Following are the results per proposition that are discussed: Firstly, the main themes and observations are discussed under the relevant propositions. Thereafter, the researcher expands on each of the major sub-themes per proposition. Finally, the chapter concludes with additional research findings as well as a summary of key findings, which will be further interpreted in Chapter 6.

### 5.2 Description of sample

A total of 18 interviews were conducted with ten business rescue practitioners (“BRP”) and eight financiers, over a period of six weeks. All the BRPs were registered practitioners with the CIPC, and the types of financiers can be divided as follows: four bankers, two development finance institutions and two private equity investors. All of the interviews involved individuals who are experts in their fields and have been involved in a consulting or advisory capacity in the field of business rescue in South Africa.

All interviews were conducted face-to-face for the duration of approximately one hour. A brief summary of the interview statistics is found in **Table 7** below:

**Table 7: Interview Statistics**

Description	Quantity
<b>Total number of interviews</b>	18
<b>Total length of all interviews</b>	1164 minutes
<b>Average length of interviews</b>	64.7 minutes
<b>Shortest interview</b>	34.36 minutes
<b>Longest interview</b>	105.32 minutes
<b>Average length of transcripts</b>	18.8 pages
<b>Shortest transcript</b>	11 pages
<b>Longest transcript</b>	32 pages

Where necessary, follow up discussions were held to better understand or clarify certain points from the interview findings.

Access to all individuals and their subsequent willing participation in the research did not prove to be a challenge. The sample obtained and the input received has enabled each of the propositions to be tested and has therefore satisfied the research objectives.

### **5.3 Data Analysis**

Within the context of qualitative and exploratory research, the researcher asserts that 18 interviews are an appropriate response rate. Semi-structured interviews were the selected research design method, which allowed the flexibility to delve into the subject in order to uncover new insights. Consequently, not all of the 18 respondents answered all of the interview questions precisely. During the interviews, recordings and notes were taken with the expressed permission of the interviewees. The recordings were later transcribed and used as a basis to verify the factual correctness of the notes produced by the scribe.

The notes from the interview were then analysed using content analysis, specifically meaning categorisation and thematic analysis (Lee, 1999) as well as narrative analysis. The use of meaning categorisation under content analysis methods were used in conjunction with the *ad hoc* methods described above to conduct the analysis.

A technological qualitative data analysis tool, Atlas.ti version 7, was used to organise and analyse the data into logical categories/constructs and themes and index the different pieces of data for easy retrieval. Atlas.ti was also used to code transcripts into key themes, concepts, questions or ideas using an inductive approach to defining the categories of the codes. The coding was utilised to build up conceptual frameworks based on common understanding/themes from the different respondent's expert knowledge.

The researcher affirms that the response selection process was adequately applied which resulted in a satisfactory respondent list.

For the purposes of confidentiality the identity of the individuals interviewed has intentionally not been disclosed in the research findings. This is in line with the research methodology outlined in Chapter 4. Ensuring confidentiality is not only deemed to be ethically responsible but also assisted in obtaining unbiased and informative responses from interviewees. Confidentiality has been ensured by allocating random respondent numbers (dissimilar to the order of the interviewee list recorded in **Appendix 3**), as well as by presenting the research findings in such way that the individuals could not be identified. Through this process the subsequent quality and content of the research findings has not been altered in any way.

## **5.4 Results: Research Proposition One - Internationally there are clear prescriptives for post-commencement finance**

### **5.4.1 Introduction and Overall Results**

Internationally there are clear prescriptives for PCF that can be identified and used as a yardstick for best practice principles around distressed financing locally. Results from the expert interviews reveal that prescriptives can be identified across the four jurisdictions analysed, with the results being summarised in **Table 8** in Chapter 5.

The super-priority status of PCF, an upfront consultative process with all stakeholders (including agreeing on pre-packaged finance prior to filing) and the strictly court driven process with highly specialised courts judges were cited most frequently by interviewees as the most common prescriptives for PCF.

The table below lists the country specific prescriptives that were identified, as well as how many interviewees cited each country. The commentary following the table provides more details on the findings.

**Table 8: Summarised ranking of prescriptives for successful PCF cited by country**

Ranking	Prescriptive	# of respondents - BRP	# of respondents - FIN
1	USA	8	5
2	Australia	6	2
3	United Kingdom	5	2
4	Canada	4	1

As can be seen from the above table, 13 interviewees of the 18 total interviewees identified prescriptives from the USA corporate rescue regime. This is likely as a result of Chapter 11 being the most well-known and successful rescue system internationally. Whilst a further eight and seven interviewees respectively identified best practice in Australia and the UK, the Canadian regulations were the least well known.

The remainder of Chapter 5.4 elaborates on the above points raised, with some pertinent quotes provided that supports the findings. Refer to **Appendix 8** for a more detailed understanding of the underlying data collected.

#### **5.4.2 Australia**

The Australian business rescue law and practices were described as being the closest to our South African rescue proceedings. Interviewees who were able to respond to the questions around Australia included six BRPs and two Financiers.

##### **The role of the Administrator**

In Australia, the official appointed to oversee rescue proceedings is known as the “Administrator”. An interesting differentiator in terms of the Administrator’s role compared to the South African business rescue practitioner (if the business moves into liquidation) is explained by the following comment from BRP5:

*BRP5: “In Australia they appoint an administrator and there he can decide to liquidate, and he becomes the liquidator, the same guy. Here the practitioner cannot be the liquidator.”*

## The approach to Business rescue

During the discussions, the interviewees shared some of the key attributes of conducting a business rescue in Australia:

- It is a large and successful industry in Australia.
- A Deed of Company Arrangement (“DOCA”) is instituted during rescue.
- The administrator performs a feasibility study upfront to gauge the prospects of success.
- It is a consultative process that takes place upfront where all major role players are consulted i.e. everything (including PCF) is agreed upon before the rescue process starts and all costs are known. This makes the process more workable overall.
- If everyone is not in agreement upfront with regards to all terms, then the rescue does not go ahead i.e. total consensus is required.
- The Administrator prepares a proposal of his analysis and his proposed plan for the business.
- The Administrator has to make personal financial sacrifices and commitments to the rescue i.e. he has to raise insurance and a bond of security, to demonstrate his belief in the business.
- The system is a hybrid between the USA and UK models of rescue, and is very similar to SA business rescue.
- The process is strictly court driven and there are specialist solvency courts where judges deal with all the rescue matters.

*FIN4: “Now for example there it is very much more formalized but much more effective in terms of their court system. So for example once you have prepared a plan you don’t present it to the creditors you have to go back to court and present the plan; obviously you need to get the creditors approval but it is quite a strictly driven court process. So they have insolvency courts with specialized judges that drive that process, and it is very strictly controlled in terms of the timeframes.”*

## Post Commencement Finance

PCF is agreed upfront by all stakeholders and has super-priority status in terms of its ranking compared to other claims. In South Africa, the PCF ranking is only the third priority.

Interestingly banks comprise only a small percentage of the total creditor base, with trade creditors making up the vast majority of outstanding debt. Furthermore, secured creditors have voting rights and generally companies do not have overdraft facilities, but rather production loans or bridging loans.

## **Rescue culture and mind-set**

Due to the personal financial involvement of the Administrator and the formalised and effective court process used during rescue, the different stakeholders are more committed to process and certain of the positive outcome of the rescue.

### **5.4.3 Canada**

The Canadian business rescue law and practices were least well known by the interviewees, with only four BRPs and one Financier able to respond to the questions around Canada.

#### **The role of the Monitor**

In Canada, the official appointed to oversee and monitor rescue proceedings is known as the “Monitor”.

#### **The approach to Business rescue**

During the discussions, the interviewees shared some of the key attributes of conducting a business rescue in Canada:

- Rescue proceedings in Canada are governed by the Creditors’ Company Arrangement Act (“CCCA”).
- The system is very similar to the UK model of rescue.

A group of Canadians were involved in writing the SA business rescue legislation, which resulted in a heavy UK and USA influence in this legislation. The concepts of compromising debt and post commencement finance were introduced by the Canadians.

#### **Post Commencement Finance**

PCF has super-priority status in terms of its ranking compared to other claims. In South Africa, the PCF ranking is only the 3<sup>rd</sup> priority. Furthermore, secured creditors have voting rights and their rankings and how they treat securities are very similar to that of the USA.

### **5.4.4 United Kingdom**

The UK business rescue law and practices are particularly evident in the informal practices of rescue and turnaround, due to the fact that the Roman Dutch law legal system is shared by the UK and SA and therefore the SA legislation and culture are

strongly aligned to that of the UK. Interviewees, who were able to respond to the questions with regards to the UK, included five BRPs and two Financiers.

### **The role of the Administrator**

In the UK, the official appointed to oversee rescue proceedings is known as the “Administrator”. All registered Administrators are maintained on registry available to the public. Their role is very similar to that of a liquidator and they will not take over management of the business.

### **The approach to Business rescue**

During the discussions, the interviewees shared some of the key attributes of conducting a business rescue in the UK:

- The process is referred to as a Company Voluntary Arrangement (“CVA”), which is a contract between the company, its creditors and the Administrator.
- The market is more mature and formalised, laws are ‘settled in’ and all practitioners know what is expected of them.
- The UK has a more mature distress investment market.
- The banks lead the process of rescue and are involved heavily throughout.
- Being involved upfront does not constitute a ‘pre-existing’ relationship; therefore the independence of the Administrator is not compromised.
- If the banks are unhappy with the Administrator’s actions, they can remove him and put their own practitioner in.
- The assessment of the viability is done rapidly upfront before the process commences. A term referred to as the “look-see”, means one can have a look into the business prior to making a decision if there is a desire to participate in the procedure.
- The process is strictly court driven and there are specialist solvency courts where judges deal with all the rescue matters.

### **Post Commencement Finance**

The concept of PCF does not exist in the formal insolvency procedures in the UK. It is critical to obtain this financing to continue the proceedings; therefore the concept is rather applied informally in practice. This means that the parties who advance financing during rescue are not pushed ahead of the queue, and therefore it is rare that other creditors rank ahead of the banks.

One BRP shared that a few years ago the UK government issued a white paper to encourage building the concept of PCF into their legislation, but it failed due to the

banks not agreeing to the proposal. The intention was to incorporate some form of financing in the procedures and to therefore have the ability to push the finances up the queue.

*BRP1: “The banks didn’t like it so it never got through basically, but they called for responses ...British Banking Association is very very strong so unless they really like some proposals they can subtly use a lot of pressure.”*

#### **5.4.5 United States of America**

The USA business rescue law and practices was the most familiar to the majority of interviewees. Many described it as instrumental to the creation of most business rescue proceedings globally. Interviewees who were able to respond to the questions around the USA included eight BRPs and five Financiers.

##### **The role of the Turnaround CEO**

In the USA, the official appointed to oversee rescue proceedings is known as the “Turnaround CEO”. An interesting observation in terms of their role is that they are not a practitioner as such, but rather take on the role as new management and stay for as long as it takes to turn the business around. This is why the company is described as being “in possession”. Therefore as described by FIN3, the “practitioner takes on a fiduciary responsibility in the company”.

Therefore management have the decision-making power during a Chapter 11 filing, and they have ultimate responsibility.

##### **The approach to Business rescue**

In the USA businesses file for a procedure referred to as “Chapter 11” when they are financially distressed. During the discussions, the interviewees shared some of the key attributes of conducting a business rescue in the USA:

- The industry in the USA is very sophisticated and has evolved over many years. The Act is very mature and has gone through many common law amendments and a vast amount of case law has been built up to set precedents and provide guidance on the interpretation of the law.

*FIN3: “Whereas in the US I had far more confidence because of a lot of case precedents, so I knew it was a fairly prescriptive process, knew what the outcome was going to be, it was productive and the process was predictable. Then the bet became*

*am I betting on the right person, with the right management team and the right business.”*

- Due to the above, any abuses of the procedure have been practically eliminated, as the system is incredibly robust with few loopholes.
- The company is “in possession” and the process is very debtor-friendly:

*BRP3: “In America it is about the interests of the debtor, the debtor company, the company that is in the process owes money to creditors.”*

- The process is intended to protect businesses in order to deal with their debts in an orderly manner and to provide legal support structures to businesses.
- Furthermore, the process intends to provide creditors with a better return than they would have received if the business went into liquidation.
- The entire planning process takes place upfront and involves consultation with all the stakeholders early on to obtain consensus about the best way forward before filing takes place. Financing is also obtained through a pre-packaged deal upfront to ensure the smooth and seamless running of the entire process.
- Filing is done through a court application process and the process is strictly court driven, with specialist solvency courts where judges deal with all the rescue matters.

### **Post Commencement Finance**

The USA have a concept called “Debtor-in-Possession” financing (“DIP Financing”). In a Chapter 11 filing the financing is arranged upfront where an individual has to issue a DIP finance application through the bankruptcy court. The financing has to be authorised by the court and have collateral (security) supporting it.

The entire process of financing is very sophisticated and well established:

*FIN3: “So to start with the US has a fairly robust systematic organized post commencement financing environment, but there are private equity funds whose sole business is post commencement financing. In the US it is called DIP financing.”*

The process of applying for DIP financing is very standardised and formalised, and all players understand on the terms and conditions of the prescriptives required.

There are various firms in the USA that were built to specialise in DIP financing, and have subsequently gained deep expertise in PCF. There are large and smaller niche players who are able to finance companies that have entered Chapter 11, and are very profitable as a result of the risks they take on. In the USA the trading of corporate

claims are very commonplace, which have resulted in the creation of many distressed funds.

*FIN3: “They knew the rules of the game; the company would file Chapter 11 on a Sunday night by Monday evening [they] had DIP financing lined up in place ... because they knew what the rules of the game were.”*

As mentioned, the financing is arranged through a tool called a “pre-pack” which is a pre-approved finance pack agreed by all parties upfront. Following this the company then files for Chapter 11.

In terms of the priority ranking of DIP financing, new financing has a super-priority status, and those players who advance DIP financing, are the first to get their money out.

*FIN3: “DIP financing is ...first money out. So it is the last capital in first capital out including all of its fees and expenses, that is all protected ... people know when they provide DIP financing, when the business exits some restructuring process they are the first capital to get repaid and their fees and expenses are protected by legislation.”*

#### **Rescue culture and mind-set**

The USA has a liberal culture of rescue and all players are very familiar with the processes. Companies are not concerned about filing for Chapter 11, as they are certain of the outcomes, and are able to continue business even if the business ends up failing.

*FIN3: “Whereas in the US I mean it is fairly common, companies are not afraid to file for Chapter 11, they are not afraid, it is not 20 years ago...there was still a little bit of stigma attached to filing for bankruptcy. By the mid-2000s post the internet bubble, you know what it is normal, every three to five years businesses file for Chapter 11. The CEO who ran it he comes out unscathed on the other side, does something different or he in many cases continues to run the business.”*

#### **5.4.6 Conclusion to Research Proposition One**

It is clear from the results that the interviewees identified a number of best practice considerations for PCF locally. The consultative nature of the processes, the early engagement with key stakeholders and the super-priority status of PCF was cited many times, and was therefore identified as the main international prerequisites for PCF.

It was interesting to note the importance of the rescue culture of a country in impacting the nature of rescue proceedings, as well as the dealings amongst the different parties involved.

The concept of “debt forgiveness” is prominent internationally as discussed by BRP3:

*“The whole thinking and rationale from a corporate rescue cultural perspective is that you have got to be able to compromise debt. That really is what they call ‘debt forgiveness’; so if you go into a corporate structure...go into a situation where there is financial stress within a company and there is a whole host of creditors who want their piece, there has got to be a buy in from creditors that are not going to get paid 100c in a Rand.”*

Furthermore, the impact of the nature of the role of the official appointed to oversee the rescue proceedings differs broadly between countries, and also influences the culture of the rescue proceedings. The foremost differences noted were with regards to those who merely oversee the process versus those who are appointed in a fiduciary capacity in the company. Furthermore, in some jurisdictions the official also becomes the liquidator of the company should it move into liquidation, whereas in other cases these two roles are intentionally split.

**Table 9** below summarises the key international prescriptives extracted from the interviews, by country and key theme.

**Table 9: Summary of key international prescriptives by country**

PCF Prescriptive				
Country	Official	Approach	PCF	Rescue Culture
<b>AUS</b>	Administrator (also liquidator)	<p>“Deed of Company Arrangement”</p> <p>Consultative process with total consensus upfront (incl. PCF)</p> <p>Personal financial commitment from Administrator</p> <p>Strictly court driven with specialist solvency/rescue courts and specialised judges</p>	<p>PCF Agreed upfront</p> <p>Super-priority status</p> <p>Trade Creditors are majority of debt holders</p> <p>Secured creditors have voting rights</p>	<p>Formalised effective court driven process</p> <p>Personal financial accountability of Administrator</p> <p>High levels of commitment and certainty</p>
<b>CAN</b>	Monitor (not a practitioner)	Similar to UK and US	<p>Super-priority status</p> <p>Secured creditors have voting rights</p> <p>Similar rankings to USA</p>	-
<b>UK</b>	<p>Administrator (similar to liquidator)</p> <p>Does not take over running of business</p>	<p>“Company Voluntary Arrangement”</p> <p>Viability assessment done upfront before filing</p> <p>Laws and practice well settled and institutionalised</p> <p>High level of certainty</p> <p>Mature distressed investing market</p> <p>Strictly court driven with specialist</p>	<p>Financing agreed upfront</p> <p>No formalised concept such a PCF</p> <p>No priority status (rare that other creditors rank ahead of bank)</p> <p>Secured creditors don’t have voting rights as already secured</p>	<p>Creditor friendly and large bank driven - Banks play a major role in influencing and leading rescue (can remove Administrator)</p>

		solvency/rescue courts and specialised judges		
<b>USA</b>	Turnaround CEO (Trustee)  Not a practitioner, but rather part of management (fiduciary obligation)	“Chapter 11” Very sophisticated and evolved industry (lots of case law) Prescriptive process and predictable Upfront consultative process Mature distressed investing market Strictly court driven with specialist solvency/rescue courts and specialised judges	DIP Financing (through the court) Super-priority status Pre-packaged finance agreed upfront prior to filing (collateral required) Process is well established, standardised, formalised, prescriptive and sophisticated Specialised DIP Financing firms	Debtor friendly (company is in possession) Management have power and responsibility to keep business afloat Incredibly transparent and robust process Parties support and embrace the process, positive with little reputational damage

In conclusion, there was strong evidence from the data to support Proposition One in confirming that there are clear international prescriptives for PCF.

## 5.5 Results: Research Proposition Two - The extent of post-commencement finance for Business rescue in South Africa is non-existent

### 5.5.1 Introduction and Overall Results

During data collection, most interviewees stated that the current extent of PCF in SA is little to none. This was a concerning fact due to the major influence that the ability to successfully raise PCF has on the overall successful outcome of a business rescue, stressed by seven BRPs and four Financiers.

Upon further enquiry as to the reason for the low levels of PCF observed, the interviewees shared some reasons why the current scenario prevails. The tables below list the reasons for the low extent of PCF that were identified, split between the two major groups of interviewees as well as how many interviewees cited each one. The commentary following the tables provides more detail on the findings.

**Table 10: Summarised Reasons for the current extent of PCF (BRP responses)**

Ranking	Extent of PCF – BRP responses	# of Responses
1	<p><b>Negative role of the banks:</b> Powerful role of banks in business rescue – sway proceedings in their favour due to majority vote.</p> <p>Banks use loan documentation inappropriately—state that you are in breach if you file for business rescue, you have to consult with them first before filing (contra to Act).</p> <p>Banks are uncompromising and unreasonable during PCF negotiations as they already have security, don't want to take a loss.</p>	2 2 1
2	<b>Newness of legislation:</b> Lack of understanding of business rescue legislation, do not want to take a risk on the “unknown”.	4
3	<b>Lack of case law and legal precedents:</b> creates uncertainty.	6
4	<b>Companies are incorrectly filing for BR:</b> delaying tactic, wrong size, receiving wrong advice.	3
5	<b>Poor quality rescue plans.</b>	3

The top five reasons for lack of PCF shared by BRPs in **Table 10**, centres mainly on how the powerful influence from the actions of banks, and their lack of cooperation in

the process, has a negative impact on the outcome of PCF negotiations. The next major reason can be clustered into the effects of business rescue legislation being very new i.e. the lack of understanding of the new legislation, lack of case law to interpret the law, and incorrect filings due to the wrong interpretation of the law. Lastly, a general observation regarding the poor quality of rescue plans is also a cause of low PCF levels.

**Table 11 Summarised Reasons for the current extent of PCF (Financier responses)**

Ranking	Extent of PCF – FIN responses	# of Responses
1	<b>Newness of legislation:</b> Processes not clear, many loopholes and inefficiencies	3
2	<b>Lack of case law and legal precedents:</b> creates uncertainty and expensive to test	4
3	<b>Abuse of the system:</b> Companies are incorrectly filing for BR: delaying tactic to buy time, receiving wrong advice. Erodes trust with Financiers	3
4	<b>Viability of business is poor</b>	1
5	<b>Lack of security</b> and available unencumbered assets	1

Interestingly, upon analysing the reasons provided by Financiers in **Table 11** for lack of PCF, three of the five reasons are exactly the same, and all centre on the fact that the legislation is still very new, ill understood and incorrectly applied in practice. The remaining two factors mentioned were the lack of security or poor viability of the state of the business.

Furthermore, interviewees shared that in the few instances when PCF is advanced, they have observed what format or shape it is provided in, as well as who the typical financiers are. The tables below list the major ambiguities identified in terms of the definition as PCF, as well as who the chief and typical post-commencement financiers are, divided between the two major groups of interviewees as well as how many interviewees cited each one.

A few uncertainties were raised regarding the definition and interpretation of what constitutes PCF, which have been detailed in **Table 12**. It is critical that these are clarified in order to provide potential financiers with the confidence that their funding will be recognised as a higher priority debt and the certainty that it will be repaid.

**Table 12: Summarised Responses for the nature of PCF: definition of PCF**

Definition: BRP responses	Definition: FIN Responses
<p>Is continued supply on normal credit terms by your trade creditors post filing PCF?</p> <ul style="list-style-type: none"> <li>• Pay newest portion of this debt</li> <li>• Doesn't have to be in the plan?</li> </ul>	<p>Similar responses to BRPs but in addition: Is any financing provided post-filing deemed to be PCF, even if it isn't in the plan?</p>
<p>The definition of insolvent is not defined in the Act.</p>	<p>Definition of financial distress – does it mean the plan has to ensure that business rescue (i.e. company profitable and sustainable) is completed in 6 months?</p>
<p>Is a controlled wind down of the business (orderly selling of assets) a successful business rescue? (i.e. the business is not saved but creditors still get a better return)</p>	

Both groups of interviewees mentioned predominantly the same types of financiers, with a few minor exceptions. Their responses are detailed in **Table 13**. Overall both parties felt that banks, trade creditors and shareholders may appear to be the apparent financiers, however the reality has shown that most of these parties have not been cooperative or forthcoming with financing due to the fact that they are only concerned with getting their money out, or they are already too fatigued to advance any more money. They often anticipate the involvement of another financier to ascertain who supports the company before responding. Development Financiers were both seen as very promising and suitable to provide distressed financing, but all interviewees found their processes too slow and bureaucratic to be able to benefit a business in financial distress. Lastly, the most promising group of financiers identified, were Distressed Lenders and Private Equity Investors. However these parties are still relatively unknown and are themselves trying to make sense of the business rescue provisions and opportunities.

**Table 13: Summarised Responses nature of PCF: Typical financiers**

	<b>BRP responses (# of responses)</b>	<b>FIN Responses (# of responses)</b>
<b>Typical Financiers</b>	Traditional Banks (5)	Traditional Banks (5)
	Trade Creditors – including competitors (8)	Trade Creditors – including competitors (6)
	Customers (1)	Customers (0)
	Shareholders (9)	Shareholders (5)
	Development Finance Institutions (8)	Development Finance Institutions (7)
	Distressed Lenders and Private Equity Firms (6)	Distressed Lenders and Private Equity Firms (6)

The remainder of Chapter 5.5 elaborates on the above points raised, with some pertinent quotes provided that support the findings. Refer to **Appendix 9** for a more detailed understanding of the underlying data collected.

### **5.5.2 Extent of PCF in South Africa**

Most interviewees agreed that the current extent of PCF being advanced in South Africa is minimal. Some feel strongly that it barely exists, saying the extent of PCF is: “*very, very little*”, “*short of non-existent*”, “*it is happening to a very limited extent*”, and “*pathetic*”. Others (mainly the Financiers) agree that a limited amount of PCF is being advanced, but that there are very specific reasons for this. Some of these reasons include:

- The banks haven’t been requested to provide PCF.
- There are no unencumbered assets or there is nothing left in the business to save.
- They don’t want to lose more money.

A more detailed analysis of the reasons has been explored in Proposition Five.

Both groups were strongly of the opinion (Seven BRPs and Four Financiers) that the success of a business rescue is intricately linked to the ability of raising PCF successfully. Therefore it is a critical success factor in every business rescue as illustrated by the comments from two BRPs below:

*BRP3: “Post commencement finance is a critical leg to business rescue...it is probably the most fundamental leg to the process, without it, it is stillborn.”*

*BRP7: “Post commencement funding is the secret to success of business rescue. Without post commencement funding you don’t have business rescue, you’ve got nothing...it’s like the oxygen tank for the patient. Without the oxygen he is going down.”*

The reasons stated for this are explained in the combined responses of the interviewees below:

- The majority of BRPs felt that the main reason for the low level of PCF lies with the **role that the bank’s play in the business rescue process**. Reasons include the fact that they often have the majority vote on the rescue plan; they sway or control the proceedings in their favour.

*BRP4: “They also try to still dictate the business rescue as well. They have got all these demands and it is not really applicable to the business rescue, but because they are the biggest secured creditor they have got the biggest vote so they can manipulate the plan by voting against it or voting for it. So they will use that muscle to then dictate the way, that is unfortunately what happens... they are just going to withdraw their support and they are one of the bigger creditors so you need to retain their support.”*

- The BRPs explained that the **banks use their loan documentation inappropriately** to avoid or sway the business rescue. The main observations in this regard is that some of the clauses in their agreements state that filing for business rescue is in breach of the contract or they force directors to sign a document that they will consult with the bank prior to filing for rescue. One of the BRPs stated that you cannot consult with one creditor as you would be giving them an advantage over others.
- Some BRPs described the **bank as being uncompromising and unreasonable during PCF negotiations**. Other creditors are generally willing to take a loss but banks are not interested as they generally have (excess) security to fall back on, but then due to the business rescue failing, all the other parties lose.
- Many BRPs explained that due to the fact that **business rescue is so new to South Africa, many stakeholders do not understand the legislation and its implications**. The market is therefore still immature and people are afraid of taking chances on the “unknown”. Therefore many also end up using the moratorium it provides to delay liquidation. Some Financiers also observed that the processes are not yet unassailable and there are still many inefficiencies and loopholes.

- One of the consequences of the newness of the SA legislation shared by BRPs, is that many of the cases that have filed for business rescue to date, **should not have filed** in the first place as they were not true rescue cases to start with. They are often trying to delay liquidation by using the moratorium. This abuse of the system erodes the trust of the Financier in the entire business rescue process.

*FIN4: “There is no doubt that people will take advantage if they see gaps... this is a new law and so it is going to have gaps and people are going to take them...That is what we see in day to day that people are definitely using it to their advantage to buy time, to buy themselves a moratorium, there is no doubt.”*

- BRPs and Financiers shared their concerns that companies also incorrectly file for rescue due to the **incorrect or inappropriate advice** that they have received from advisors.

*FIN5: “I think a lot of people are misusing it to - especially when you see the inevitable thing of it going into liquidation, again a lot of the time from advisors, legal or financial, people that just say file for business rescue, but they don’t understand the impact.”*

- Some of the BRPs also mentioned that the advancement of PCF is heavily affected by the **quality of the rescue plan**. It requires certain critical information and should emphasise the feasibility of the business.

*BRP1: so if you are wanting to loan this money from any business so it is a successful business and it starts up, and you approach a funder and they want to see projections and cash flow forecasts; if you are going to ask somebody for financing in a business rescue they want to see the same things...I would also expect sensitivity analysis on the forecast, I don’t know if people do it here. Whatever your key sensitivities are in the business, people tend to overestimate when they forecast...never put a plan together that won’t protect whoever is putting the money in.”*

- A major factor that many BRPs and Financiers also stressed is that the newness of the business rescue legislation in South Africa creates ambiguity in the market regarding the interpretation and application of the Act. Therefore the **lack of case law and legal precedents** have made industry players reticent to test the law as it is expensive and no-one wants to be the example.

*BRP4: “You see the problem with case law at this stage, I am not prepared as a business rescue practitioner to go and test certain issues on the Act by going to court, who is going to pick up the tab, not me, not to rewrite the law. If it happens in the normal course of business while you are busy doing a rescue, yes so be it.”*

*FIN2: “At this stage in South Africa, and the only way we are learning is through case law, the fact that if somebody is put into business rescue one can still debate the merits before a judge and a business rescue application can be set aside....We can’t put in millions for us to be a precedence setting case, and I think most of the financiers feel the same way.”*

- **Lack of security and unavailable encumbered assets** are a major reason why Financiers believe that no PCF is available.

*FIN5: “You get to the point where they file for business rescue, there is either nothing or very little as it stands, that is not encumbered already...because you seldom find that there is fixed property or anything else that is not encumbered”.*

- Financiers also stressed that if they **do not see the potential of the business**, they are reluctant to advance funding. However there are certain exceptions where banks may step in to provide funding, even if the business is dying. Some of these exceptions are discussed in Proposition Four and Five.

### **5.5.3 Nature of PCF in South Africa**

In defining the nature of PCF, the following aspects were analysed: a) how PCF is currently defined, as well as b) the typical financiers of PCF.

#### Definition of PCF and mechanisms for PCF

The discussion regarding the definition of PCF mainly followed the definition in the Act; however a few ambiguities were raised by BRPs and Financiers alike during the discussion regarding what constitutes PCF. The general consensus is that any financing provided post-filing is deemed to be PCF, even if it is not in the plan, but this is yet to be tested in the courts.

*FIN1: “There is that whole debate, does post commencement finance have to form part of the plan or can you give it outside the plan. We have seen that you can give it outside, but obviously then if the plan is not approved you run the risk of letting it go into liquidation so you have to be careful around that and giving it straight away or not.”*

A matter that was debated was whether continued supply on normal credit terms by trade creditors, after filing for business rescue, constitutes PCF. It also does not have to be in the plan to constitute PCF; all financing provided post-filing is deemed PCF and will therefore enjoy the priority status. Therefore if a trade creditor supplies post-filing, they are no longer a “creditor” for that particular amount, but rather a post-

commencement financier. Furthermore, a loophole was identified in the legislation with regard to the definition of insolvent. As BRP4 explains:

*BRP4: “In the old Act Section 339 it was there, it said if your liabilities exceed your assets, but in the new Act there is nothing like that, and in the liquidity it says to not be able to pay your creditors in the next six months, immediately or in the next six months. Now that is quite simple, there is no terminology like insolvent; so yes that is also a loophole in the Act, it has got to be defined, insolvent needs to be clearly defined.”*

A further nebulous area of the Act concerns the definition of financial distress and how this relates to the successful ending of business rescue proceedings. It was unclear whether the six months referred to, also means that the business is required to be profitable and sustainable in six months following business rescue.

Upon enquiry of which types of mechanisms are used to fund PCF, the following examples were provided by the interviewees:

- Asset Based Lending based on receivables and stock
- Lending against any unsecured asset
- Buy out the bank’s debt at a discount
- Buying equity in the business
- Debt to equity swap and effectively writing off the debt
- Recapitalisation through a compromise with creditors to inject additional funding
- Buy up dissenting creditors voting rights, thereby offering them what they would get in a liquidation and then pushing the business rescue plan through (“binding offer”)
- Shareholders put additional money in
- A new entity buys out the existing debt and/or equity through acquisition
- Sell some assets to raise capital
- Additional overdraft funding

Conducting a controlled wind down of the business would also result in a successful business rescue, i.e. through the selling of the assets or buying out the business itself, which does not save the business but provides the creditors a better return. The overall consensus is however that there is no set type or trend of mechanisms, but that it rather depends on the situation

*BRP1: “It depends on the situation; it is a bit like a game of snooker - all the balls are on the same spot but every game is always slightly different; so you have just got to look at the situation and scenario and what the key points are and what the key [peak points] are, what the releases are and that is where the problem is.”*

## Typical Financiers of PCF

When posed the question of who the typical financiers of PCF are, the responses were varied and are detailed below. The main stakeholders that were mentioned are the banks, creditors and the shareholders. Most of these parties would want to investigate the company to establish whether they believe in its viability and whether they want to provide the business with another chance. Overall however, the interviewees stated that it mostly depended on the type of business and its current financial situation, and what the risk appetite of the lender is.

- Banks

One of the types of financiers mentioned by five BRPs and five Financiers is the traditional bank as a lending institution. The views on the role and effectiveness of banks in business rescue are varied and extreme, with some feeling the banks do not cooperate where others explain that they will only get involved if they believe the business has potential. The overall feeling is that the banks will get involved if they were involved previously with the company and are protecting their asset or if they believe in the future of the business. However, generally they are conservative lenders who price for high risk. It is highly unlikely that they will ever take an equity stake in a business, as that is not their core mandate. They also do not have a specialist rescue unit or a separate business rescue product as business rescue is not their core focus; therefore all these cases are dealt with as part of their normal credit processes.

*BRP7: "Well these are credit people and they will evaluate whether there is a good chance of success or whether it is just time to cut your losses and throw good money after bad, but the easiest thing is to always criticize banks or major creditors that they don't do more. But even the capitalist society most of these companies have got as their state of objective to maximize shareholders' wealth and you have to be mindful of that; so if you have a pure social agenda and you want to save jobs irrespective of whether the company is going to survive or not survive, you get your money back or not that is different. I wouldn't expect that major creditors or banks would simply take money and toss it unless they believe they have a reasonable chance of getting it back."*

- Trade Creditors

The second potential type of financiers are trade creditors or suppliers of a business. Eight of the BRPs and six Financiers touched on the role of trade creditors in PCF, with views ranging between creditors continuing to supply on revised terms (e.g. COD) as they see the long term potential / benefit of the business relationship or they would be

crippled without this client; whereas others are not familiar / comfortable with business rescue, and only want to ensure they retrieve as much of their money out of the process. Trade creditors are ideal for certain short-term working capital needs. An interesting observation is that in some cases, where the company in business rescue is a strategic partner or key competitor, the trade creditors may take equity in the business or buy the business altogether to obtain a strategic asset or access to a customer base.

*FIN1: “Trade creditors yes; so what some practitioners do is they say okay for the debt prior to business rescue you will follow the normal process but post commencement we will pay you COD on a 30 day basis or whatever and then they will negotiate those terms because otherwise they can’t operate; so they do need to make some negotiations with them and it depends if some are willing to and others are so cross that they just say no or they can’t to cripple their own business.”*

- Customers

An interesting type of financier mentioned by one of the BRPs is that of the customers of the business.

*BRP1: “Customers are a route that is often overlooked but it depends on the business though. Again the customers might like the product so much that they are prepared to put some money in, or they need it and it is absolutely key for their product.”*

- Shareholders

Nine BRPs and five Financiers mentioned shareholders as a potential financier of PCF, particularly if they are also serving in management / directorship positions i.e. part of owner-managed businesses. However, due to the tendency of businesses to file too late for rescue, shareholders’ appetites to advance funding reduce drastically. This is even more challenging in the case of a public company, due to the sheer number of shareholders that need to be managed. The further reticence of shareholders stems from the fact that they generally have the most to lose in a rescue or liquidation situation, due to their low rankings in the priority of repayment and low levels of protection. The form of funding is usually in the form of loan finance.

*BRP5: “The problem with shareholders is that most of these normal run of the mill business rescues, by the time you get there the shareholder is pretty much down and out, he is so tired he can’t think straight anymore, he is at the end of his tether and this is his last throw of the dice.*

- Development Finance Institutions

Due to the nature of the mandate and key strategic objectives of a Development Finance Institution, many BRPs and seven Financiers felt that institutions such as the Industrial Development Corporation (“IDC”) and the Development Bank of South Africa (“DBSA”) are ideal candidates to advance PCF in rescue situations. They often become involved where there is a broader developmental or social agenda at stake. However the biggest inhibitor of these organisations in being effective in this space, is the length of time that they currently take to authorise the provision of financing and the level of bureaucracy built into their internal processes. This limits the freedom and agility that the BRP requires as part of his role. As described in Chapter 2, from the time of filing the business rescue plan generally has to be signed off within 25 days, whereas typically the IDC and DBSA take three to six months to complete their due diligence, decision making and authorisation processes. Their inability to move swiftly was described by eight BRPs as a huge deterrent to involve them to raise PCF.

*BRP4: “Okay my experience with the IDC is that they will most probably come in as the post commencement funder of the future. They will have to go through a serious evolution to adapt to the time constraints of what is required in Chapter 6 in terms of the law. I think they are in a good position to actually distribute government funds...but unfortunately...they are very internally focused still and I haven’t got three months for them to do due diligence, I have got ten days to do my own...Development Bank of South Africa, also too conservative, too much red tape.”*

All of the above factors lead to the problem that they are unable to finance a business rescue in a practical business structure mainly due to their slow decision making. A suggestion made by two of the BRPs is that the IDC should create a business rescue / distress fund with the goal of saving jobs, which is run by an independent individual / firm and audited regularly. The fund could be made available to senior BRPs and / or approved commercial banks that have the ability to make financing available to distressed businesses on short notice.

An instance where the role of the IDC or DBSA has been beneficial is where they were previously involved as a creditor in a particular business, as this would speed up decision making. It is therefore important to contact them early on if their involvement is required in the business.

Upon discussing these matters with the Development Finance Institutions (“DFIs”) themselves, the following insights were shared:

- Both institutions have a different mandate to other financial institutions i.e. they are more focussed on the developmental and social impact rather than pure commercial viability, and may sometimes override the commercial considerations. Their main stakeholders are government rather than the shareholders.
- The IDC currently has a distressed fund facility that is available to all financially distressed companies, regardless of whether they have filed for business rescue or not.
- In terms of their process, the IDC firstly perform a desktop helicopter assessment, following that they then provide the details of the assessment, and then lastly, decide whether this business can be salvaged or not. Should it have feasibility, the IDC then provides the funding.
- Currently the IDC sees PCF as beneficial, but to date they have not advanced any PCF, especially in terms of new clients. Some of the reasons are that they are hesitant to create a fund / facility specifically focussed on PCF as they feel the guidelines are still blurred at this stage. As with the other financiers, they are hesitant to spend a large amount of money on precedence setting cases, therefore they would not readily provide PCF.
- Furthermore, the IDC's core priority is to provide distressed funding to primarily protect their existing clients. Traditionally the workout and restructuring function has always been a support function, but more recently there has been an increase in the number of independent distressed clients approaching the IDC and these would then be reviewed and investigated as part of their operational unit.
- One of the strategic focus areas is to preserve or improve the quality of the assets for the bank, therefore if the company's proposal does not do this, they will be more reticent to assist and participate.

Therefore these matters need to be weighed up on the balance of all factors to appropriately mobilise DFIs.

- Alternative Financiers: Distressed Lenders and Private Equity Firms

The last major category of financiers is broadly referred to as “alternative financiers” and includes organisations such as Private Equity (“PE”) firms, Venture Capital (“VC”) firms as well as Distressed Lenders (“DL”).

Six of the BRPs and six Financiers have advised that they believe that the future of PCF lies with these firms, as the traditional financiers do not currently display a sufficient appetite for PCF. These entities generally have a higher risk appetite. These entities would typically buy out distressed debt and / or have PE / VC funds available to

utilise for this purpose. The potential attraction for them to this industry is the higher risk-return investments, buying debt or assets at depressed prices, higher payment priority in terms of the PCF rankings and potential debt to equity swaps in cases where they have identified a viable business with long term prospects.

The experience of the BRPs have however been that these entities are very interested in the opportunities, but are still enquiring into the business rescue landscape and building up their own knowledge and understanding of the industry. Generally the current activity is focussed more on the informal distressed investment industry, which is still very niche-specific and under developed. The Financiers also mentioned that the current market for PCF is still very small, but that there are many businesses in financial distress. The South African PE and VC industries are also still very small, undeveloped and relatively unknown in the market.

*BRP5: “The typical players would be venture capitalists and people who have an appetite to have a higher risk and a higher return type situation. It is not panned out fully in South Africa, it is not developed yet; there is lots of talk about creating an equity fund and whatever but that is just ideas that are just mulling around at the moment. Everybody talks about it but no one has really gotten down to actually bed it down...There are a lot of people sitting checking out how it is working and waiting for people to burn their fingers.”*

Furthermore, these lenders are currently still very anxious about the uncertainty in the industry, e.g. the risk they take on by investing funds prior to the approval of the business rescue plan. A further deterrent referred to by some of the Financiers is that they believe the PCF legislation is currently too vague / ambiguous to provide the PC Financier the confidence that they will receive their money back. Once this has been overcome the market has great potential for growth.

*FIN3: “Why bother with something risky and complicated and something that is still opaque in the court law when we can go and pick fruit elsewhere.”*

An interesting observation by one of the Financiers is that often the existing shareholders would step in if there were a new investor, else their shareholding would be diluted. More specifically, regarding DLs, BRPs and Financiers mentioned that these types of organisations are very well entrenched in international business rescue markets such as the USA and UK, and generally have a rapidk response time in assisting a business in distress. Their approach is one of taking an equity stake in the business, and then working with existing management to turn the business around, whilst demanding high returns on their investment. They have a completely different

view on the business compared to that of a traditional financier (e.g. banks), as they accept the unusually high risk associated with the business and walk a long term journey with the business until it has recovered and provided a decent return to compensate for the risk taken.

The respondents stated that there is a lot of money to be made in distressed debt market through either buying up of distressed debt at deep discount (buying and selling of distressed consumer debt at a discount from the banks) or qualifying for a priority ranking in terms of PCF. However, the trading of corporate claims and buying up of distressed debt at a discount is still a very nascent space in South Africa.

Sadly the presence of DLs in South Africa is either unknown or non-existent, and few products have been designed to accommodate the high level of risk associated with this type of financing. Therefore BRPs and management do not have this financing option readily available for accessing. However the interest in the field is growing as people become more comfortable with the concept and the risks involved, and some PE funds have been in discussions about establishing distressed funds, but none have been forthcoming.

#### **5.5.4 Conclusion to Research Proposition Two**

It is clear from the results from the interviewees that there is currently a concerning low level of PCF, but that there are some specific reasons identified for this. The most prominent reasons provided all point toward the implications of the newness of the legislation, which means it is not well understood, sometimes abused and often incorrectly applied in practice. These are mostly explored in the discussion of Proposition Five. The most important elements to emerge were lack of interest shown by traditional financiers and the nascent nature of the alternative financiers in South Africa. It is particularly interesting to note the number of concerns mentioned regarding the ambiguity and uncertainty still surrounding the interpretation of the Act and the need for additional case law or precedents to provide players in the industry with the confidence to get involved.

It can therefore be concluded that the data does indeed support Research Proposition Two i.e. that the current extent of PCF in South Africa is non-existent.

## 5.6 Results: Research Proposition Three - Post-commencement finance has clear phases

### 5.6.1 Introduction and Overall Results

The general response to this question from BRPs and Financiers alike was that the different phases would be determined by, and detailed in, the business rescue plan itself, therefore it would include all financing required from filing (day one of business rescue) until the closure of rescue proceedings. It would also further be affected by the particular context of the business itself, and the product or service that it provides.

Currently there is a perceived high risk for a lender advancing financing in the period after filing but before approval of the plan. The reason for this is believed that, should the plan not be approved, there is no clarity about whether this will constitute PCF and whether the lender will be repaid. Although this appears incorrect in terms of the definition of PCF in the Act, the view amongst certain financiers reinforces this perception:

*FIN1: "It is not part of the plan so there is that whole debate, does post commencement finance have to form part of the plan or can you give it outside the plan. We have seen that you can give it outside, but obviously then if the plan is not approved you run the risk of letting it go into liquidation so you have to be careful around that and giving it straight away or not."*

*FIN2: "Now, post commencement finance by definition is only applicable to an approved and adopted business rescue plan. That comes in 30 or 40 or 50 days after that event, so the business rescue practitioner during that time doesn't have rights of borrowing unless there are unencumbered assets of the company...but he cannot provide the guarantee that there will be pay back."*

**Table 14** below lists the three key phases of PCF that were identified during the interviews, as well over what period each phase stretches. It was noted that each phase may be financed by a different lender. The commentary following the table provides more detail on the findings.

**Table 14: Summarised Findings for the key phases of PCF**

Phase #	Phase Name	Period
1	Critical and Emergency Funding	Post-filing to first meeting with creditors
2	Pre-Plan Funding	After Phase 1 funding has been stabilised to pre-rescue plan approval
3	Post Plan Exit Funding	After rescue plan until business has come out of financial distress

The remainder of Chapter 5.6 elaborates on the above points raised, with some pertinent quotes from the interviewees provided that supports the findings. Refer to **Appendix 13** for a more detailed understanding of the underlying data collected.

### **5.6.2 Phase 1 - Critical and Emergency Funding**

The first major phase that was described is the financing required after the business has filed for rescue, which is often required imminently to keep the company alive, and used to stabilise the bleeding cash flows. This has been referred to as “flash cash”, “emergency funds” or “critical vendor funding”, and is the most desperate funding required. It is often done through paying wages of workers, paying utilities to keep the operations running, cutting out excess stock, minimising payments and maximising repayments from debtors and any critical working capital requirements. This phase takes place from the date of filing until the first meeting of creditors.

This type of financing is often the most challenging to obtain as it is generally still early in the rescue process and the BRP has not yet had an opportunity to assess the business and its future viability. For this reason banks and trade creditors are also wary of providing financing, and when it is provided, it is often advanced at a huge premium and is therefore very expensive.

*FIN4: “I think probably the most difficult thing for us is the post commencement finance is needed between date of business rescue and the plan. Once the plan has been formalized then it’s easier to deal with any issues.”*

FIN2 explains the typical sources and nature of PCF in the first phase:

*FIN2: “The shareholder and the company would probably provide the first round of funds. That first round of funds would come in from internal cash or an additional shareholder loan to establish the first phase. That first phase is from the time of*

*business rescue to the time of getting the creditors together, the first meeting...So the first phase is establishing the business rescue.”*

### **5.6.3 Phase 2 - Pre-Plan Funding**

The second major phase of financing required after the critical vendor funding, is the pre-plan approval financing. This usually occurs once the initial cash flows and operations have normalised, and the BRP has performed a full assessment and due diligence of the company in business rescue, up to the approval of the plan. During this period the BRP would also be developing their plan for presentation to the creditors. This includes the strengths and weaknesses of the business, who the productive and redundant staff members are, and identifying any quick wins for the company.

*FIN6: “What can I quickly fix so that I can make money immediately. That is where they will need cash...normally it is not a lot of money where you are just trying to make sure that if it was just producing a set of products so that we can deliver...you are more inclined to say let me pump in money to that activity which is realizing most value...Once you have focused on the short term issues then you are looking at the medium and long term issues.”*

In terms of the Act this period continues until the 25<sup>th</sup> day point where the plan has to be presented to the creditors, but in practice this time period can stretch to three months (or later if an extension was sought). This phase of financing is normally provided by the trade creditors who provide extended credit terms or alternative payment arrangements; or alternatively the bank that extends its overdraft to the company. Financing for this period is critical as a business can only last for so long without operating normally and having access to financing.

*FIN5: “What business can survive without doing business for three months; by the time you get here then there is no business to continue with. I think this is the essential part to get this funding, between filing and approval of the plan.”*

At the end of this period and before completing the plan, the BRP should also have made an assessment of whether the business is “rescue-able” or whether it is better to liquidate it.

*FIN3: “At the 90 day financing mark you either know you have to shoot this thing in the head or you can do something with it. That is what is missing in our legislation too is this check point after a certain period of time.”*

#### **5.6.4 Phase 3 - Post Plan Exit Funding**

The third and last phase of financing required for PCF is all the financing proposed and approved by creditors in the business rescue plan at the second meeting of creditors. This type of financing is also referred to as “exit financing”.

In this phase the long term stabilisation and survival of the business is analysed and often involves some crucial restructuring activities such as changing the business model, selling non-core assets, investing in new capital expenditure / refurbishing existing assets, diversifying the business or entering new markets. Due to the nature of these activities the magnitude of the financing required is much greater than the previous two phases as well as the period over which it is required, and it determines the nature of the financing required.

One of the Financiers proposed a guiding principle when providing PCF for this stage of the rescue:

*FIN2: “However post commencement financiers need to be very well aware that [in] the post commencement plan you cannot provide short term funding for long term assets. So if the business rescue plan is actually a complete turnaround of the business where there [are] additional assets, new business model...and those things will only take three to five years to show any return - the business rescue practitioner needs to advise and apply on the basis of post commencement finance but on that long stage.”*

Once this has taken place the risk on the balance sheet of the company reduces.

#### **5.6.5 Conclusion to Research Proposition Three**

The evidence from the findings clearly reveal a defined three phase process of PCF needs, including the timelines over which these stretch, as well as the typical financiers. In conclusion therefore, the data supports Research Proposition Three i.e. that PCF has clear phases.

## 5.7 Results: Research Proposition Four - Prerequisites for successful post-commencement finance can be identified

### 5.7.1 Introduction and Overall Results

During the interviews a range of prerequisites for success were shared by both Financiers and BRPs. Many themes corresponded between the two groups of interviewees, however there were also numerous items identified that were unique to a particular group. These differences have been emphasised below.

**Table 15** below lists the seven key prescriptives that were identified, the number of times the item was mentioned in interviews, as well as how many interviewees cited each prescriptive (by key interviewee group). The commentary following the table will provide more detail on the significant findings.

**Table 15: Summarised Ranking of prerequisites for successful PCF from BRPs and FINs**

Ranking	Prerequisites for success (number of mentions)	Mentioned by # BRPs	Mentioned by # FINs
1	The availability of security (34)	8	6
2	The impact of the profile and actions of the Business rescue practitioner (32)	6	7
3	Financiers require a sustainable plan based on a viable business (30)	9	6
4	Distressed business should involve and engage Financiers upfront prior to filing for business rescue (22)	6	3
5	Filing for business rescue by distressed businesses to take place earlier (15)	6	3
6	Relationship of financier with management and the BRP: Trust, Openness and Transparency (8)	4	6
7	Existence of another financial backer / potential buyer (7)	2	3

Some of the other main factors mentioned were:

- The risk of losing more if they do not provide funding,

- To protect or preserve their existing security, and
- The value and commercial viability of additional financing is visible and certainty of being repaid.

As can be seen from the above table, 14 interviewees of the 18 total interviewees felt that the most important criteria for success is having sufficient security available, whilst a further 13 interviewees felt that the role of the BRP has an immense impact on the ability to successfully raise PCF. Lastly, 15 interviewees stated that a critical success factor is the existence of a viable business model, supported by a sustainable rescue plan.

The remainder of Chapter 5.7 elaborates on the above points raised, with some pertinent quotes provided from the interviewees that support the findings. Refer to **Appendix 11** for a more detailed understanding of the underlying data collected.

### **5.7.2 The availability of security**

The success factor that was quoted most amongst BRPs and Financiers alike is the availability of security for use by the business / practitioner to obtain financing. It was mentioned a total of 34 times (8 BRPs and 6 Financiers) as a critical factor to secure PCF.

The key aspects brought out by the BRPs and Financiers, are mainly reflected in their experiences of working with the banks. Generally the banks are not at all interested in advancing PCF unless there is a sufficient amount of unencumbered assets available as security. When there is security it reduces the risk for the financier, as well as provides them with more assurance that they will be paid back. Therefore, Financiers stressed that it is highly unlikely that they will advance any PCF unless there are sufficient, high quality unencumbered assets left.

*BRP7: "You are either investing in a dream or you are investing like a pawn broker against good tangible security. Not that many people are investing in dreams; there are people who are investing against security that is the main phase at the moment."*

Security is usually provided in the form of fixed assets (i.e. property, machinery etc.) or current assets (e.g. debtors, inventory or even an order book).

A further disincentive for banks to invest in PCF is the fact that they generally already hold sufficient security to cover their liability and therefore any additional financing provided would dilute their own investment.

The exception to this is that some Financiers, especially developmentally focussed lenders, may analyse the soundness of the business model in addition to the sufficiency of the security.

*FIN6: “Essentially I think the starting point for lending money is the soundness of the business and the model...so the first step is to make sure that you are happy with the business and you are happy with the financial model. Then as a secondary now to support and minimize the risk that was has been projected does not happen, that is when you then look at the issue of security.”*

### **5.7.3 The impact of the profile and actions of the Business rescue practitioner**

The second most cited success factor that was quoted amongst BRPs and Financiers alike is the reputation, behaviour and actions of the BRP in order to obtain financing. It was mentioned a total of 32 times (6 BRPs and 7 Financiers) as a critical factor to secure PCF.

The crucial aspects shared by respondents regarding the role of the BRP are as follows:

- The ability of the practitioner to provide a **proper pre-assessment of the business**; perform a **thorough analysis of the rescue and liquidation scenario**, as well as demonstrate a **sound understanding of insolvency legislation**, is critical in order for the BRP to determine the viability of business rescue and associated next steps.

*BRP5: “I think the ability of the practitioner to provide a proper analysis of the liquidation scenario, because if you are at sea when it comes to understanding the laws of insolvency and how people would rank, then there is no way that you can present anything to prospective financiers that will give the guy confidence to put the money in.”*

- **Experience in the industry, expertise, skill-set, qualifications, reputation as well as the track record** of the BRP, is critical in obtaining PCF. Therefore the personal brand of the BRP has a significant impact on the success of his efforts to obtain PCF.

*BRP7: “Well imagine you wake up one morning and you decide to go and get a bank overdraft, run a business that is in distress and the bank doesn’t have a clue who you are, they do not know what your qualifications are, they do not know what your experience is, they have no understanding of your track record - what do you think your chances are of being able to successfully access money, why would people give you money?”*

- However, one of the Financiers mentioned that as the overall quality of rescue plans improve in the industry, the impact of the individual should decrease.
- The **ability to engage with and persuade Financiers** to see the potential in the business and have funding lined up early. BRPs must have a vision of where the organisation is going and be able to sell the vision to all the other parties that are encountered along the path of business rescue.
- BRPs have to have **powerful and effective networks and relationships in the industry**.

*BRP10: “Whether you like it or not relationships also come into the equation; if whoever is going to put the funding in is comfortable with the jockey then that is already a hurdle that you have overcome. But if they are not comfortable with whoever the practitioner is then I think your chances of raising post commencement finance is gone.”*

- Two BRPs stressed that **experience in the financing industry** (e.g. having worked in the banking sector) is also incredibly useful as the necessary networks can be maintained, as well as a good understanding of the strategic requirements of a Financier and their preferences in terms of layout, style and packaging of the rescue plan. The benefit is also that they would be more prone to approaching the banks before filing to obtain PCF. This can however also cause the BRP to be more conservative in its approach.
- BRPs should also **not take on too many cases** as they need to be involved in the day to day involvement of running the business.

*FIN5: “Also I think in the day to day involvement in a business rescue is much more involved. We have a couple of liquidators that also did business rescues for us, and even they acknowledge that it is not like a liquidation where you sort of from the sideline manage the process; it is every day, you are responsible for it with the board. So the FD or the sweeper or the tea lady, she phones you and asks if she can buy coffee and tea, it is a daily involvement.”*

- The Financiers stressed that the BRP should have the **right team on board** with the required skills to diagnose the business, in order to ensure a successful rescue.

#### **5.7.4 Financiers require a sustainable plan based on a viable business**

The third most cited success factor that was quoted amongst BRPs and Financiers alike is the requirement of a sustainable rescue plan presented to the Financiers, which

are backed up by a viable and sound business. It was mentioned a total of 30 times (9 BRPs and 6 Financiers) as a critical factor to secure PCF.

The vital aspects shared by respondents with regard to a sound plan and viable business are as follows:

- There must be a **viable business and underlying business model** accompanying the financial model that is worth funding. This would be supported by sufficient security and a competent management team. The DFIs in particular analyse the fundamentals of the business and then analyse the available security.

*FIN2: “The business model...I don’t want to know about your balance sheet...I am saying what is driving this business, your revenue line. I want to see that revenue line, so if we have comfort in the business model, the projections, the markets, we will back any restructure because you can restructure a balance sheet until you are blue in the face, how do you want to skin a cat. But that revenue line, if your product is not in demand, if you are not providing it at the right quality you are not going to get the market.”*

- There must be a **sound and sustainable rescue plan** which is worded carefully and considers the appropriate ranking of new PCF advanced. The plan should also have a clear strategy around what is required to rescue the business and should include cash flow projections. The end result should be that the Financier has confidence in the plan and the BRP, as they can see that the causes of distress have been dealt with. To date many of the plans received have been poor and have not included the appropriate facts.
  - Reliance on the independence of the BRP is important for the Financiers, as they seek independent confirmation regarding the state of the business.

*FIN5: “That is where the business plan comes in, because obviously whatever they have been doing up to now to get them there wasn’t working so you have to see what is going to change, what is going to be different. I almost want to equate it to a new client walking in the door and we say give us your business plan; I mean the rescue plan is sort of the new business plan.”*

#### **5.7.5 Distressed business should involve and engage Financiers upfront prior to filing for business rescue**

The fourth most cited success factor that was quoted amongst BRPs and Financiers alike is the requirement to engage with and involve financiers prior to filing for rescue,

to ensure they are party to the process from the start, rather than a recipient of it. This may also include the formalisation of a “pre-packaged” agreement. It was mentioned a total of 22 times (6 BRPs and 3 Financiers) as a critical factor to secure PCF.

The vital aspects shared by respondents with regard to upfront engagement with Financiers are as follows:

- Many of the respondents stressed that **engaging the bank or creditors** (and any other major stakeholders) in discussions concerning the financial situation of the distressed business, **prior to filing** for rescue, is critical. Financiers have a higher likelihood of providing financing should they be part of collaboratively compiling the plan, rather than pouncing on them post-filing,

*BRP1: “If everybody is working together, the management of the company, the bank, then they [bank] might consider it if they think it will help rescue the business...If you do business rescue by discussion with the key stakeholders before you actually go into business rescue, then you are able to work out the extent to which the existing funder will be prepared to continue financing. But just to go and look for post commencement financing out in the market, there doesn’t seem to be much of it around...So one of the prerequisites to me is the involvement of ourselves [BRPs] beforehand, before the resolution is passed.*

- One of the key reasons for the upfront involvement is to measure from the Financiers whether there is an **appetite for PCF**. Through this process the unofficial approval for PCF from the respective Financiers is obtained. A recommendation was made to formalise this practice in line with international laws like those of Australia.
- Concurrently with the process of consulting the Financier prior to filing, a “**pre-packaged**” (“**prepack**”) **agreement for financing** should be agreed amongst the strategic stakeholders. These types of agreements have been in place in informal turnarounds for the past few decades.
  - Some concerns still remain that this type of upfront involvement would constitute a breach of the BRPs independence, according to the CIPC conditions entailed in issuing a licence to practice as a BRP. This has yet to be clarified.

*FIN1: “We [financiers] said you need to come and talk to us; and they [BRPs] said well where does the conflict come in. So if they go and do a pre-assessment and decide... get the banks around the table and say this is what we need, we want to go into business rescue but we need your support, we need some funding, we need this and*

*that, are you on board....then are they independent and we say yes you are. But some people's view is that because they have been involved in the business for a month or whatever there needs to be a fresh person who is appointed."*

#### **5.7.6 Filing for business rescue by distressed businesses to take place earlier**

The fifth most cited success factor that was quoted amongst BRPs and Financiers alike is the requirement for businesses in distress to file earlier for business rescue when they realise they are in trouble. It was mentioned a total of 15 times (6 BRPs and 3 Financiers) as a critical factor to secure PCF.

The crucial aspects shared by respondents with regard to early filing by distressed businesses are as follows:

- BRPs explained that the **earlier a company in distress files for business rescue**, the higher the likelihood of obtaining PCF. The reason for this is twofold:
  - It gives the BRP more time to secure PCF through discussions and negotiations with the financiers, and
  - The business is generally in a healthier financial position and would therefore be able to attract more PCF through available security.

*BRP3: "But talking about getting in early in the process, it is a key, it is a fundamental and that is why the definition of financial distress talks about six months, not whether you are financially distressed now, is will you become financially distressed in terms of the definition in the next six months period. Which means get in early if you are going to file for business rescue and that gives the practitioner time to raise things like post commencement finance...in theory once a company tells the world it is financially distressed you have got to have a plan or it is the death [for the business]."*

- The company should be **guided by the six month time frame defined in the Act**, which requires the business to identify whether they will have a cash flow problem in the next six months. The problem is that currently no-one monitors whether directors adhere to the Act in this regard. Should all companies follow the law strictly, then most should never need to commence liquidation proceedings. When a company waits too long to file it erodes the trust in the relationship with management and could lead to the financier taking legal action in terms of the business not notifying them with six months' notice that they were in distress.
- Financiers also commented that should a business commence the informal process of consultation and rescue earlier, it **opens up more options** to the business and

provides the financier an opportunity to help solve the problem, rather than having to file for rescue at the last minute and scramble to obtain PCF.

### **5.7.7 Relationship of financier with management and the BRP: Trust, Openness and Transparency**

The sixth most cited success factor that was quoted amongst BRPs and Financiers alike is the state of the relationship between the pre-commencement Financier and management of the distressed business and the level of confidence that they have in the current management. It was mentioned a total of 8 times (4 BRPs and 6 Financiers) as a critical factor to secure PCF. It was noteworthy that this aspect was mentioned far more by Financiers than BRPs.

The crucial aspects shared by respondents with regard to the attributes of openness, honesty and transparency in business rescue are as follows:

- Management have a responsibility to extensively disclose to all parties the facts on the table about the business, once they have filed for business rescue. Financiers stressed the importance of transparency and open communication throughout the entire process, and all dealings with them. They want to feel a level of comfort with the existing management. This will ensure a successful business rescue.
  - These attributes equally apply to the conduct of the BRP with the financiers.
  - One BRP however commented that as soon as you do disclose the facts about the situation the business is in, the banks lose their appetite.
- Management is critical to the success of a rescue and can sometimes stand in the way of what is required to save the business. This is particularly the case in owner-managed businesses.
- The entire process of rescue should be more transparent, according to on Financier. This will raise the level of accountability required for all parties involved.

*FIN3: “The rescue process here I think should be much more visible, much more transparent, far less power to the restructuring consultant and the lawyers and far more in the public view of the judge who can then make nice and rational decisions...The headline is that there needs to be a lot more clarity and certainty in the business rescue process to formalize, and when you formalize it you are going to see results.”*

### **5.7.8 Existence of another financial backer / potential buyer**

The seventh most cited success factor that was quoted amongst BRPs and Financiers alike is the presence of a third party who has already committed to provide financial

backing, either by providing financing or buying the business. It was mentioned a total of 7 times (2 BRPs and 3 Financiers) as a critical factor to secure PCF.

The main aspects shared by interviewees regarding the role of a financial backer are as follows:

- BRPs shared that should **another party volunteer financing** (e.g. shareholders, potential buyer, etc.) then the Financiers (particularly banks) will be more likely to advance PCF, and not require additional security. In this way they would receive a preferential claim and have the assurance that another party is comfortable with the business. The difficulty with this is that one party might be waiting for the other before they advance PCF.

*FIN4: “We said in order to provide post commencement finance we need to know that there is a player and then obviously they came on board and then we were prepared to take a risk. We provided it in both instances without additional security but knowing full well that we will have some form of preferential claim.”*

#### **5.7.9 Other prerequisites for success**

Both Financiers and BRPs mentioned a host of other prerequisites for PCF, which were mentioned no more than five times each by both parties. These factors are all reasons or requirements where a Financier is more likely to provide PCF.

#### **The risk of losing more if they do not provide funding**

This is often the case where a Financier already has large exposure to the client, and should they not provide funding, they risk losing more in the end if the business fails. Therefore there is a higher risk in exiting rather than continually fuelling the business. If they finance the business through PCF, they would get a better return than if the business was liquidated.

*FIN5: “Sometimes you have to agree to the business rescue position if you are in a certain situation...I think it is mainly in cases where we have to manage our own risk where if our return is better by going through this process than it would be in a liquidation; then I think we would go that route.”*

The Financier and the BRP would keep calculating the liquidation dividend for creditors at different stages of business rescue, to determine when it is no longer viable to continue.

### **To protect or preserve their existing security**

A further reason why banks may provide PCF, which is closely linked to the previous items, is in order for them to preserve their existing security or current position. The size of their current exposure is also a major consideration for whether they will advance any further financing.

*BRP5: “In order just to protect their notarial bond which they had over computer equipment and IT equipment ...they had to advance the money in order to keep the business afloat, in order to protect the value of their security.”*

### **The value and commercial viability of additional financing is visible and there is certainty of being repaid**

If the bank can see that through providing financing they will make a profit and recover their money, they are more likely to proceed. It is often not something they would willingly do under normal trading conditions, but due to the fact that they will be better off commercially after financing, they are compelled to do so.

Furthermore, if providing further financing will increase their likelihood of being paid, banks would strongly consider this as cause for advancing more money. Therefore it is critical that the bank has a high level of certainty that the money they are investing will be repaid.

*BRP10: “I think there should be some sort of certainty that whoever is putting the money in is going to be able to get it back, or maybe not certainty but a very high likelihood of it being repaid; because if they can’t overcome that then nobody is going to put money in unless the return is so high that they make enough that they don’t lose capital.”*

### **5.7.10 Conclusion to Research Proposition Four**

Many of the interviewees explained that the prerequisites for success vary greatly from case to case and there is no defined list of criteria that will work in all instances. Variables that may impact the success could include the type of company, the industry in which it operates, the age of the company, the size of the company, geographical locations, whether the company is listed or is a non-listed entity, etc.

*FIN4: “I think for me I have always said we deal with these matters on a case by case basis and that is the message I have given to my team. Case by case. You cannot in every instance, and we have been through this many times about having a checklist and we do have a sort of broad base check list that we use, but it is not prescriptive*

*and I have told my guys that; because in every instance you are going to have a different scenario.”*

Therefore the evidence from the findings clearly reveals a set of prerequisites for successful PCF needs, which can be utilised as best practice in raising funding for business rescue. In closing, as echoed by BRP6 below, if the business is worth saving and there is a party that has the funding to back it, the rescue will be a success.

*BRP6: “if there is somebody with money that has a reason to want to save the business it will work.”*

In conclusion therefore, the data supports Research Proposition Four.

## **5.8 Results: Research Proposition Five - The reasons for lenders’ disinterest in post-commencement finance are clear**

### **5.8.1 Introduction and Overall Results**

The response to this proposition was the most voluminous and comprehensive of all the questions posed to interviewees. The reasons for the failure in the quest for PCF also invoked the most passion and frustration by interviewees.

**Table 16** below lists the eleven main reasons for the disinterest of lenders in PCF, the number of times each were mentioned, as well as how many interviewees from each group cited each prescriptive. The commentary following the table will provide more detail on the findings.

**Table 16: Summarised Ranking for the reasons for disinterest in PCF by lenders from BRPs and FINs**

Ranking	Prerequisites for success (number of mentions)	Mentioned by # BRPs	Mentioned by # FINs
1	The impact of the profile and actions of the Business rescue practitioner (51) *	7	6
2	Business rescue filing by distressed businesses for wrong purpose and too late (46) *	7	6
3	Business rescue culture and perceptions of business rescue in South Africa (45)	8	5
4	Concerns and uncertainty regarding the priority ranking of PCF (38)	6	4
5	Banks are conservative and risk averse due to regulations such as Basel (23)	4	7
6	Financier risks losing money (21)	6	4
7	Lack of cooperation by banks during business rescue proceedings (20)	7	5
8	Distressed business should involve and engage Financiers upfront prior to filing for business rescue (13) *	2	3
9	State of the relationship of financier with management and the BRP (5) *	2	2
10	The availability of security (4) *	2	1
11	Financiers do not have comfort in the rescue plan based on a viable business (4) *	-	3

(\*) Previously identified in Proposition 4 as a prerequisite for success

Some other reasons mentioned by interviewees are:

- Lack of accurate and reliable information
- Opposing interests
- Lack of regulation of industry
- Distrust in the business rescue system and the degree of opaqueness in the interpretation of the Act
- Company size
- Lack of awareness, education and understanding of business rescue
- Financiers do not want to lead the precedence setting process
- Banks do not want to lose control of the process

Six of the prerequisites for success discussed in Proposition Four, closely correlate inversely to the reasons for disinterest by financiers. These items were numbered below as 5.8.2 to 5.8.8. Where there has been duplication with the data provided in Proposition Four, this has been removed or summarised.

The remaining five reasons centre on a host of factors such as the influence of the banks, the South African rescue culture and uncertainties that exist in the industry with regards to PCF rankings.

The remainder of Chapter 5.8 elaborates on the above points raised, with some pertinent quotes provided by the interviewees that support the findings. Refer to **Appendix 12** for a more detailed understanding of the underlying data collected.

### **5.8.2 *The impact of the profile and actions of the Business rescue practitioner***

The most cited reason for disinterest quoted amongst BRPs and Financiers alike is the reputation, behaviour and skills of the BRP in order to obtain financing. This also includes their independence in the rescue proceedings as well as the fact that a number of them have had to be removed from business rescues. All of this undermines the credibility of the person and the process. This factor was also mentioned as one of the prerequisites for successful PCF. It was mentioned a total of 51 times (7 BRPs and 6 Financiers) as a major reason why PCF is not being raised.

The significant aspects shared by respondents regarding the role of the BRP are as follows:

- BRPs could **incorrectly place a business in rescue in order to earn practitioners' fees**, even though they know the business should rather be liquidated. They may also not conclude on rescue soon enough due to lack of knowledge or experience to identify the signs that a business should move into liquidation.
- Many respondents agree that BRPs **do not have sufficient track records, appropriate competence or the required business experience** to take on business rescue cases. There are currently too many practitioners who are “fly by nighters”. They also do not advise the company filing for rescue appropriately, and many companies end up using it as a delaying tactic. Financiers therefore become wary of the BRPs and it erodes the confidence they have in their abilities, which in return reduces the likelihood of providing PCF or approving the plan.

- It was observed by both interviewee groups that BRPs **take on too many cases** at any one time, which results in them not working efficiently nor devoting themselves to the cases. In order to complete a thorough business rescue analysis and take over the day to day management of the business in distress, they should only take on a few manageable cases at a time and would therefore not require the extensions on the timelines that they currently request from creditors.

*FIN4: “Looking at what is happening elsewhere it is reasonable, but the guys are either not competent enough, they are not devoting themselves to it, in other words there needs to be more dedicated approach to a particular matter not taking on 20 or 30 matters or however many and you just juggle and outsource and you do whatever to just get the job done to get the volumes and get the revenue...Now we are taking a firmer stance regarding extensions, so we are not just agreeing to extensions now, we are saying justify it, if you can’t justify it we are going to take it up with the commission that you are not doing what you should be doing and so forth; because a lot of the guys are not actually actively involved in doing something. It is again this juggling that we get the feeling that a lot of them are too busy with other things.”*

- **Lack of regulation of BRPs** is a major concern for all stakeholders. Currently there is no regulator that actively monitors or controls the conduct of the BRPs and no core professional body who manages, regulates and accredits practitioners.
- Some concerns were raised over **who is eligible to practice as a BRP and the lack of concrete guidance**, with different professions being brought into question. Concerns about liquidators becoming BRPs were also raised, due to their reputation and the unregulated industry in which they operate and therefore whether they possess the required competence and skill-set to become a BRP. A concern was also raised regarding the appointment of lawyers as BRPs, as their main focus is on the legal process and ramifications, and not necessarily on the true business dilemmas that the business faces. Mixed views were raised regarding accountants. A recommendation from a Financier was to ensure the BRP works with a multidisciplinary team comprising of all the skills that are needed, on each business rescue case.
- If the **BRP has good relationships with the banks**, they will have a much higher chance of success in raising PCF, than someone who does not, as the banks are comfortable working with people they know.
- Due to BRPs only being brought into the company after filing the entire process starts off in a rushed and reactive manner. Therefore best practice **requires BRPs**

**to complete an upfront assessment** before the company files to determine whether it is a candidate for business rescue and to potentially line up Financiers.

- The involvement of the BRP before filing has been brought into question due to the **potential compromise of their independence** in the case. The Act requires an independent practitioner to be appointed and therefore the CIPC enforce this requirement. Both the BRPs and Financiers alike feel strongly that not allowing minimal upfront contact and a pre-consultation is an incorrect interpretation of the Act, and that the pre-assessment prior to filing is critical to the success of the rescue, and is paramount in being able to secure PCF upfront. The recommendation is that as long as they do not have a personal interest in the venture or were previously an official advisor / consultant to the business, their independence would not be compromised by a few upfront meetings.

*BRP3: “The one interesting thing about a practitioner, you normally find the practitioner engaging with the creditors pre-business rescue. When they appoint him there is an argument that that practitioner is now tainted because he is no longer independent. My view...is that that can never be the intention of the Act. The Act says appoint someone who is independent not related to the company, not related to directors, certainly don’t appoint a non-executive director, someone who is independent - the fact that he was asked to go in by a creditor to assess whether this company is good or bad for business rescue doesn’t taint his independence. I think it is reckless of directors not to do that...one day someone is going to challenge it on the basis that that practitioner wasn’t independent; but then it will be argued and a judgment will come out to say do you know what it is in fact necessary and then the law will be set and I don’t think it will be an issue.”*

### **5.8.3 Distressed business should involve and engage Financiers upfront prior to filing for business rescue**

One of the most cited reasons for disinterest quoted amongst BRPs and Financiers alike is the fact that most businesses do not involve their Financiers upfront in discussions if they are in distress. Instead, the Financier generally finds out about the distress once they have received the notice of the filing. This factor was also mentioned as one of the prerequisites for successful PCF. It was mentioned a total of 13 times (2 BRPs and 3 Financiers) as a reason why PCF is not being raised.

The vital aspects shared by respondents concerning upfront engagement with Financiers are as follows:

- Often the **banks only receive a notification of business rescue after it has already been filed**, which is sprung upon them and destroys the trust and relationship they had with the company. Neither the BRP nor management speak to the bank beforehand to advise them of the rescue proceedings. This affects their willingness in advancing finance and guarantees that PCF will not be obtained from them.

*FIN1: “The minute we get a notification and we look at that conduct as bad, we immediately stop the account...we will stop the overdraft limit and withdraw facilities because we don’t know what is going on in the business. We would prefer them to come and talk to us and say this is the story, we are not about to close our doors but we do need a little bit of time or we need to restructure something and this is how we are going to go about it. Then we are happy and we will support them as much as we can; but when they spring it on and they say the meeting is in two days and we go and there are a million creditors who are jumping up and down, then we are not prepared to support in some of those cases.”*

- Similarly the **BRP should engage with the bank concerning the assessment and plans** for the business, prior to filing for rescue. Often the Financiers state that the BRP incorrectly assumes that the bank will keep their current facilities going.

#### **5.8.4 Business rescue filing by distressed businesses for wrong purpose and too late**

The second most cited reason for disinterest quoted amongst BRPs and Financiers alike is the fact that many businesses file too late for rescue, file for the incorrect purpose or should not be filing at all. This factor was also mentioned as one of the prerequisites for successful PCF. It was mentioned a total of 46 times (7 BRPs and 6 Financiers) as a major reason why PCF is not being raised.

The crucial aspects shared by interviewees with regard to early filing by distressed businesses are as follows:

- It is critical to determine whether the company that has filed, is **truly a business rescue case or rather a liquidation case**. This would be determined by whether there truly is a business left to save. The nature of the business will determine whether there are opportunities for funding.

- Both BRPs and Financiers have experienced that when companies face increasing legal pressure, they decide to file for rescue in order to **benefit from the moratorium on claims** and buy more time to determine a strategy for survival. Rescue is being used as a **delaying tactic** or a decoy for businesses that should be liquidated. Business rescue is often a **reactive response** when the company's Financiers have already stated that they are no longer able to assist the business. Sadly in these cases, the business inevitably becomes liquidated, as there was no viable prospect from the outset of proceedings.

*BRP10: "Well I think there is a lot of abuse at the moment and if you look at the single biggest reason why they [the banks] oppose it is the view that a lot of the business rescues that have started are companies that should go into business liquidation rather than be rescued. The fact that it is going into business rescue is just the abuse of the process and delaying the inevitable. So they don't want to be dragged along and therefore they go and oppose it."*

- As described above, this has resulted in a gross **abuse of the system** including where a business files for rescue with the intent of merely selling off assets (which could have been done in a liquidation situation) rather than the intention of turning around a business in financial distress. Similarly, by placing a property development company (which is not an operating entity) in business rescue that is having challenges in releasing funds and therefore does not need PCF. In many of these cases **companies are ill advised by their legal counsel and other advisors**. Critical considerations—such as who will fund the rescue—are not planned out early enough. Banks have built up experience to quickly identify these cases and decide upfront that they will not support the plan.
- **Filing for rescue often happens too late** and Financiers are not advised in good time. If they filed earlier, the Financier could have assisted them with alternative solutions.

*FIN6: "Half the time companies will agree to go into business rescue when it is too late. They never tell you their problems until they are having to fight fires. We always tell clients look we are here to work with you, if you tell me that there is a problem coming up and I work with you, half the time we can solve it. But half the time even if they are almost about to bend their office they will tell you no things are fine - so by the time they actually come to you it is already too late."*

#### **5.8.5 The availability of security**

One of the reasons for disinterest shared by BRPs and Financiers alike, which was also the prerequisite for success mentioned most, is the availability (or lack) of security. It was mentioned a total of four times (2 BRPs and 1 Financier) as a reason why PCF is not being raised.

The BRPs discussed the fact that the major potential weakness with PCF is that it is heavily reliant on the pre-existing Financiers, as well as the fact that the extent of security they have access to, limits the amount they are willing to fund. The Financiers' disposition is very focussed on the unencumbered security in the business and will unlikely provide any funding beyond what is available.

#### **5.8.6 State of the relationship of financier with management and the BRP**

Another reason for disinterest shared by BRPs and Financiers relates to the state of the relationship between the Financier and that of management and the BRP during the business rescue procedures. This factor was also mentioned as one of the prerequisites for successful PCF. It was mentioned a total of 5 times (2 BRPs and 2 Financiers) as a reason why PCF is not being raised.

The BRPs explained that by the time the business files for rescue, and the financiers become aware of the state of the business, it is often too late to rectify the relationship. The **trust and confidence in the business and management has already been eroded**, as the Financiers feel misled, and they are generally unwilling to work any further on the matter. This is exacerbated if the financier feels that the BRP is collaborating with management of the business. Therefore it is not a matter of disinterest in PCF on the side of financiers, but rather one of distrust and doubt.

#### **5.8.7 Financiers do not have comfort in the rescue plan based on a viable business**

When Financiers are hesitant about the quality of the plan they receive or are not confident about the soundness of the business model of the company in distress, they may be disinterested. This view was shared only by Financiers and mentioned as one of the prerequisites for successful PCF. It was mentioned a total of four times (3 Financiers) as a reason why PCF is not being raised.

The Financiers explained that should they feel that that a particular industry or business model is not going to improve or turnaround soon, or they are overexposed to a particular sector, they may not provide financing. This is also the case when they do not believe in the current management team. Furthermore, if the plan does not provide them with comfort and the quality of it is poor they are even less likely to consider advancing PCF. This is often exacerbated by the fact that the process and plan are conducted outside the prescribed timelines.

*FIN5: “Again going back to the practitioner’s responsibility, I think the quality of the plan is really poor...if it was new business and someone put this in front of me and asked will you give me funding I would say no. It is really poor quality of rescue plans that we are seeing. I would almost say if it wasn’t for the input from the bank in the ones that we approved, then it wouldn’t have gone through.”*

#### **5.8.8 Financier risks losing money**

When the banks risk, or perceive that they are at risk of losing money during business rescue proceedings, they will unlikely be interested in advancing any more financing to that company. This factor was shared by BRPs and Financiers and was also mentioned as one of the prerequisites for successful PCF. It was mentioned a total of 21 times (6 BRPs and 4 Financiers) as a reason why PCF is not being raised.

The main aspects shared by respondents regarding the risk of financiers losing money are as follows:

- BRPs shared that many financiers are cautious about business rescue as there is a **perception that they will lose money**. The BRPs believe this is an incorrect perception and is based on the ignorance or lack of knowledge of the Financiers.
- A common factor mentioned is that banks have a policy of “**my first loss is my best loss**” and they would rather exit than invest and risk losing any more money. Furthermore, the banks are interested in asset growth, which a distressed asset will not provide them. These companies are always seen as “problem children” and not opportunities.
- BRPs also shared that the banks are largely workout officials, and **business rescue is out of their comfort zone**. Therefore they shy away from it, particularly as they do not fully understand the industry and still associate it with the practises under the old Insolvency Act.
- One of the principles of business rescue is that the return to creditors under business rescue should exceed what they would receive in the case of liquidation

(liquidation dividend). However, as soon as a party advances **PCF this may potentially dilute the return that creditors will receive in business rescue**, and eventually make liquidation more attractive. The length of time it takes to take a business through rescue is also a disincentive. This may also be a reason why Financiers are disinterested in PCF, or if they do advance it, it is only to maintain or improve their current position.

- Financiers are generally not interested in funding companies that are in decline, and **would rather invest their funds in businesses that would assure them of good returns and comfort that they will be paid back**. They might consider it in exceptional circumstances, where the funding might turn around the company; however they are already losing money with a declining business and do not want to expose themselves to further losses.

*FIN6: “Generally speaking as banks we are very reluctant to offer funding to a project which is actually going down ... you don’t want to put in money because you are already losing money... So there is obviously loss of value, it might not be very high value but there is always loss that you already bear. So now when you bring in an aspect of then putting in more money it means that the potential loss at your exposure has actually increased beyond what was originally at risk.”*

- Furthermore, if the BRP does not believe that the post-commencement Financier will get their money back, they **should not accept the funding** and rather look for other alternative options.

*BRP10: “But if you go through a process and the practitioner is not comfortable that if the post commencement financiers do put money in that they are not going to get it back; but the practitioner shouldn’t be accepting that money and that is also part of the reason why I would close the doors. Even if I had gotten that cash in it would have sorted out one month and then the next month I would have had the same problem; and getting back to the earlier equation of creditors in liquidation versus business rescue, they would have been going backwards.”*

- An interesting alternative view from a BRP explains that as **banks are accountable to shareholders**, they cannot be expected to invest in ventures or transactions that are too risky and not guaranteed of a positive return for shareholders.

*BRP7: “It’s very simple people always believe that the banks should do more, the banks aren’t doing enough and throughout the world there is a big anti bank bias, but the truth of the matter is if you were a shareholder in [a bank] and they were taking your funds and gambling on what were clearly poor odds, how would you feel as a*

*shareholder?...But you can't ask people to take their hard earned savings or banks earnings and put it into speculative ventures which have little chances of success. That is why they are in business rescue."*

- Lastly, as the financier often has cession of debtors as security on their exposure, any collection of debtors should be paid back to the bank / financier. However what often happens is that all incoming cash flows are used by BRP to pay different commitments to other creditors. Banks are not comfortable with this practice and often argue that these collections are their contribution to PCF.

The remaining reasons mentioned below, discussed in 5.8.9 to 5.8.13, were new aspects raised by interviewees as reasons for lenders' disinterest in PCF.

### **5.8.9 Business rescue culture and perceptions of business rescue in South Africa**

The third most cited reason for disinterest quoted amongst BRPs and Financiers alike is the perception that the business community and financiers have regarding business rescue, as well as generally the culture of rescue in South Africa. This has a major impact on the openness and willingness of stakeholders to participate in this new process. It was mentioned a total of 45 times (8 BRPs and 5 Financiers) as a major reason why PCF is not being raised.

The vital aspects shared by interviewees with regard to the rescue culture in business in South Africa are as follows:

- Many of the respondents shared that due to business rescue being very new in South Africa there is still a **long way to go in terms of changing the mind-set and embracing a rescue culture**. Many of the other countries where the rescue regime is working well institutionalised the practice and the culture over the past 15 to 20 years.
- For a long time **SA has adopted a liquidation mind-set**, and therefore it is unlikely that they are going to switch over the business rescue overnight. Therefore a major shift is still required from a traditionally liquidation focused culture to establishing a debtor-friendly rescue culture. The belief is that new culture is non-existent at this stage as there is still an **inherent distrust** among management, banks and creditors due to the historically creditor friendly disposition in business. The "old school mentality" will only be altered over a longer period.

*BRP3: “In South Africa it...has always been creditor focused because of our history in liquidations and directors taking creditors for a ride. There is an inherent distrust between creditors and banks and management that is just historically where we are. There again it is a mind shift to start looking at the debtor company and elevating it lets rather save it than kill it.”*

- The **business rescue provisions were intentionally written into the Companies Act**, as opposed to the Insolvency Act to not make an association between the two, and to stimulate a different pattern of thinking about business rescue. This is a unique feature of the SA business rescue legislation. Unfortunately, due to the legacy of liquidation in the SA business history, and the levels of distrust described, the association to insolvency has been transferred to business rescue, which is exactly what the legislation and CIPC were attempting to avoid. An interesting alternative view from a BRP is that ultimately **business rescue is still an insolvency procedure** and nothing more, as a business in financial distress is still being saved and one can compare it to a liquidation situation.

*BRP3: “Now why did they do that to try and keep liquidation and insolvency separate and not have this connotation of liquidation and insolvency in business rescue? That comes back to the mind-set. You see liquidators were always looked at very circumspectly because there were a lot of issues with the Masters Office and enquiries, political fallout, bribery and corruption in the liquidation industry. What the CIPC the new Company’s Office doesn’t want is to have the new business rescue process tainted...they want to keep that dirty word of insolvency out.”*

- ~Part of the perception may also be caused by our **archaic and restrictive legislation regarding people who have failed in business**. It does not support the concept and purpose of rescue, as is evident in the USA. An individual cannot be a director for a period of five to ten years, resulting in a loss of application of those learnings they obtained from the failure they have been involved in.
- Over and above the rescue culture, it was noted that **SA has a very different business culture to overseas counterparts**. Reference was made to their style of operation and their lack of appetite for long term scenarios. South Africa still has a very immature business market and a small business community, therefore reputation damage is permanent which makes directors in distressed companies reticent to ask for help. When distressed companies are in trouble; they go into their shell and do not alert anybody to the problems. Lastly, mistrust and uncertainty between business and government exists in SA. All these factors make it much more challenging to make business rescue a success in SA.

- One Financier commented that business rescue may negatively impact the culture of lending in South Africa, as a result of recent cases where a lender's voting rights were put aside.

#### **5.8.10 Concerns and uncertainty regarding the priority ranking of PCF**

The fourth most cited reason for disinterest quoted amongst BRPs and Financiers alike is the concerns raised regarding the uncertainty and ambiguity surrounding the priority ranking of PCF. It was mentioned a total of 38 times (6 BRPs and 4 Financiers) as a major reason why PCF is not being raised.

The significant aspects shared by interviewees with regard to the ranking of PCF are as follows:

- First and foremost, BRPs shared that the **rankings follow the South African laws applicable to the liquidation rules of listing of debt**, therefore you have to rank the creditors in their respective categories of preferred, non-preferred, secured, unsecured, interest free, and interest payable, etc.
- The **understanding regarding the ranking order priority of PCF** is as follows:
  - The practitioner gets paid first right at the top in terms of section 135-3, including his disbursements. (This ranking may compromise any security that the post-commencement financier had).
  - Then all employees that have worked during the business rescue / post commencement finance period (in terms of the Act sections 134-135 they are deemed to be super-priority post-commencement financiers). This provision is unique to SA (This ranking may compromise any security that the post-commencement financier had).

*BRP3: "Now the Act and the legislator clearly recognized how important jobs are in South Africa and that is why they have put this in, to ensure that rather go into a business rescue to keep your workforce ticking over and we haven't yet seen trade unions take advantage of this. If you think about it, let's assume there is a wage dispute, if they were clever they would then say okay in terms of the Act there is provision which allows only trade unions and employees to ask for the financials of the company, no one else."*

- Secured lenders or creditors who had security in place before business rescue OR secured post commencement Financiers in the order it was

granted. (There is **little clarity about whether secured creditors will rank ahead of PCF lenders**).

- Insolvency creditors.
- All other creditors (includes employees remuneration before business rescue) (**No clarity with regards to the priority ranking of unpaid taxes**).
- One of the concerns raised regarding the above ranking is the fact that **distressed investors are not comfortable with the current rankings of PCF**. The reason for this is that they **rank after secured lenders and preferred creditors**, and therefore have a lower probability of getting their money back. Therefore even if they provide PCF, they will be lumped in with the pool of creditors, which provides no advantage or incentive for them to advance PCF. The order of ranking of PCF in SA is not the same in the USA and Canada, where post-commencement Financiers have a super-priority claim above other lenders / creditors. Therefore the recommendation is that the Act should be amended or case law should be established to prioritise PCF above other creditors. Until this happens, the PCF industry will not develop.

*BRP4: “The Chapter 6 seems to be problematic for them because contrary to what you have got especially in Chapter 11 and in Canada is the preference of your post commencement funding. Our post commencement funding, your secured creditors and your preferred creditors are first in line in priority and then only the post commencement funder.”*

- One of the counter arguments to this is that if it changes, **the creditors who were secured beforehand are prejudiced**, as their asset base is depleted. One of the reasons that secured creditors do not agree to the business rescue plan is that another party will provide financing and hence rank above them.
- One of the suggestions from a BRP is to adopt one of the provisions in overseas business rescue legislation, where **pre-commencement funding is also included in the prioritised post-commencement funding**, as a reward for the willingness to advance PCF.
- A Financier commented that one of the challenges of PCF is that if equity financing is advanced, the right to PCF return is lost.

#### **5.8.11 Banks are conservative and risk averse due to regulations such as Basel**

The fifth most cited reason for disinterest quoted amongst BRPs and Financiers is the fact that banks are by nature very conservative and risk averse, due to the various

restrictive regulations (such as Basel 3) that they have to comply with. Basel is a set of regulations which governs the capital requirements and lending and risk profiles of financial institutions. This restricts them in terms of how much they can lend to specific types of risk profile clients. It was mentioned a total of 23 times (4 BRPs and 7 Financiers) as a major reason why PCF is not being raised.

The important aspects shared by interviewees with regard to the conservatism and risk averse nature of the banks are as follows:

- Banks are **risk averse and conservative** and therefore not interested in PCF, as they do not yet fully understand their position in business rescue. Banks have shared that in most circumstances, even if there were unencumbered assets in a distressed business, they would probably not advance funding, as it is too high risk for them. They only provide funding on the exception to distressed businesses.
- Banks operate in a highly regulated environment, are **restricted from lending** to certain categories of high risk clients, through capital reserving requirement formulas from **regulations such as Basel** which they need to comply with. Basel and many other policies regulate the pricing of debt that banks issue, therefore when lending to a high risk client, the price of the debt for that client will increase, sometimes at unfeasible rates. Therefore they have to have certainty that they will be repaid, hence the requirement for security when lending.

*BRP10: “Because of this Basel 3 they have got all sorts of requirements that they have got to comply with...I know a lot of bank debts that are sold are dictated or the sales are pressurized or pushed because of the Basel 3 requirements...it all goes back to the Basel 3 on what their reserving requirements are. There is a pricing issue as well because they are not getting that return then they have got to do something.”*

- The best option currently for banks is to use debtor financing, up until such time as the bank creates a fund exclusively for use by its clients in distress. The **banks have not yet created a separate product offering for businesses in rescue or for PCF**. Therefore they deal with clients in business rescue as per their normal credit policies.

*FIN5: “It just doesn’t make economic sense in that sense to do it in a normal banking environment; if it is nonperforming and you have to have 100% capital for your borrowings in terms of the pricing, is just going to be unaffordable to actually put it in for the bank to make a return.”*

### 5.8.12 *Lack of cooperation by banks during business rescue proceedings*

The further reason cited for disinterest quoted amongst BRPs and Financiers is the lack of cooperation observed from banks during business rescue proceedings. It was mentioned a total of 20 times (7 BRPs and 5 Financiers) as a major reason why PCF is not being raised.

The main aspects shared by respondents with regard to the lack of cooperation by the banks are as follows:

- BRPs perceive that banks have **unofficially made a policy decision that they are not in favour of business rescue**. Therefore regardless of the merits of the case, they are unlikely to advance PCF. Some of the reasons include that they are out of their comfort zone.
- Banks were described as “an obstacle” and “not playing ball” in terms of business rescue cases where there are justifiable reasons why they should get involved. They generally **appear uninterested** in the matter. Banks **do not see PCF and the practice of distressed lending as their full time job**, hence them not being interested in this space. The reasons provided were that they see they will fare better in liquidation than to continue with business rescue. Therefore they are not concerned about the impact of their decisions on other parties and they do not want any other creditor to benefit more than them.

*BRP3: “You would think that the banks in the right matters would prefer the companies to remain under a business rescue process than go into liquidation; liquidation is negative, it is about job loss, it is about small dividends to creditors etc. But you are finding that the banks are not necessarily pushing for business rescue...this legislation really was created to save jobs, keep businesses afloat etc.”*

- Experience has also taught that as soon as a client advises that they are filing for rescue, or advises that they are having financial difficulties, the **bank’s response is to call up the overdraft facility**.
- The banks themselves shared that at this stage they **are scared to get involved and need convincing that lending to businesses in distress will be beneficial to them**. Banks perceive clients in rescue as “problem children” and do not see the opportunities surrounding business rescue.
- The banks also shared that they are **taking a firmer stance** going forward on provision of funding and on extensions of deadlines for the rescue plan.

*FIN4: “So really we are adopting quite a firm stance regarding that in terms of funding going forward...you see it puts pressure on the company because now if we don’t pay anything beyond and we start to fire cheques, debit orders what have you, what does it do, it brings people to the party....Obviously what we are generally doing now as a first point of call is taking a firm stance; so our stance has definitely shifted from the early days where we would’ve kept funding in place or limits in place, we are cancelling [them out]. So we are saying the utilization is your limit and we are putting a peg in the sand pending the practitioner engaging with us. We are kind of forcing their hand because they are not communicating with us properly as they should do.”*

### **5.8.13 Other reasons for the disinterest of financiers**

Both Financiers and BRPs mentioned a host of other reasons for disinterest of Financiers in PCF, which are detailed below by major category. These are listed in no particular order:

#### **Lack of accurate and reliable information**

- The lack of confidence in accurate and reliable data or sufficient and available information used for analysis and assessment of the company during business rescue was mentioned by one BRP and two Financiers as a key factor for lack of PCF.

#### **Opposing interests**

- One of the problematic factors mentioned by two BRPs is the fact that in business rescue there are often individuals with completely different interests and emotions during business rescue. Responses are sometimes emotional and driven by a lack of trust.

*BRP2: “The owners don’t want to pay anything and they want to come out pearly white and clean, the banks don’t want to risk anything and the creditors want to get paid. So your interests are totally diametrically different, that is why there is no way that you will ever be able to put them in a box and say well that will work for everyone. It is just not possible.”*

#### **Lack of Regulation of Industry**

- One of the major concerns raised by both BRPs and Financiers was the fact that there are **no regulatory bodies managing practitioners, nor a body monitoring the current *ad hoc* system of appointments**. The system is neither sustainable

nor effective, and due to the shortage of sufficiently skilled BRPs, has resulted in under qualified practitioners being appointed to rescues, who in turn tarnish the reputation of the industry. This would include regulating the number of cases a practitioner may take on at any point in time.

- The respective **roles of the banks/creditors, practitioner and management are neither formalised nor transparent enough, compared to international standards**. The BRP has too much power and the banks have too much weight. Because of the agency relationship, no-one takes full accountability for the outcome. A recommendation was to use the model used in Chapter 11 of the USA where management (the debtor-in-possession) has the power, and most other decisions are driven by the law and case law precedents. The banks themselves have admitted to the major influence that they have in proceedings.
- A request was made that the CIPC should play a more important role in regulating the industry; there is a need for someone to play the “refereeing role”.

*FIN4: “The DTI the commission needs to play a more significant role in my opinion in the sense that they need to play a role similar to the role the master plays in the case of liquidations. They have got to set the rules of the game, they have got to police it, and they have got to do all of those good things around the process and practitioners as well in particular.”*

#### **Distrust in the business rescue system and degree of opaqueness in the interpretation of the Act**

- BRPs explain that a large part of the reason that Financiers are not interested in PCF is due to the fact that they **do not trust the system, or the players within the system**. There is a high level of uncertainty and ambiguity around the processes in business rescue, resulting in an erosion of confidence in the industry for all parties involved.
- A further problem is that there are **many questions which have remained unanswered in the application of the Act**, and due to this uncertainty the parties involved are sceptical to about getting involved as they do not have confidence about the outcome.
- The Financiers agree that the legislation is good in principle, but more rules of the processes and application of the legislation are required. A suggestion was made to **create equivalent “Practice Notes”** (as in the field of accounting / auditing) to assist those in the industry in interpreting the intention and application of the law accurately.

## **Company Size**

- Some BRPs mentioned that PCF is not raised where the company size is too small, as Financiers are generally more interested in companies where either their exposure is larger, or their potential for a return is greater.

## **Lack of awareness, education and understanding of business rescue**

- BRPs expressed the concern that **many directors do not understand the provisions and implications of business rescue**, and that an awareness / educational programme is needed to make them aware of their role and accountabilities. They also do not understand the costs involved, or that they lose full management control over the business. The same applies to creditors, employees and Financiers who do not understand how business rescue works, and therefore shy away. In particular parties do not understand the purpose and impact of the moratorium.
- A suggestion was that the CIPC should embark on **an educational program** in this regard. Alternatively, those parties such as auditors could play a role in educating and alerting companies to business rescue.

*BRP4: "In South Africa they don't understand moratorium. The moratorium is actually on taking legal action against the debtor that is the only moratorium. The moratorium is not there for you now to stop making payment now for six months, that is what the business rescue practitioner is supposed to negotiate...If you stop you are in breach basically, Chapter 6 doesn't change the breach, and it stops the action that they can take against the company in terms of the breach. So those are all factors that impact negatively against post commencement funding."*

## **Financiers do not want to lead the precedence setting process**

- Many of the Financiers shared that even though they may want to provide PCF, due to the uncertainty around the guidelines for PCF, they do not want to pursue these cases in court and spend money to be a precedent setting case. Therefore everyone is adopting the "wait and see" approach.

## **Banks do not want to lose control of the process**

- When a company goes into business rescue, the bank immediately loses control over the account with the client, as well as potential risk of losing any security they had secured upfront. Even though they are still able to influence the proceedings by being the major creditor, they are less inclined to want to advance PCF as they are already the major creditor and do not want to risk losing more. In informal

turnaround situations, banks used to control the process and therefore they are not comfortable with advancing PCF when they are no longer in control.

*FIN6: “So now when you are in business rescue you are no longer a creditor in control, in as much as you might be secured by other assets in the business...the business rescue practitioner can actually take your asset which you say is your security and use it to borrow money. They are within their rights to actually do that.”*

#### **5.8.14 Reasons for lack of PCF by distressed lenders**

One of the viable potential sources of PCF suggested by many interviewees is distressed lenders who are largely unregulated and willing to take on additional risk in order to gain an attractive return on the financing advanced. However during the course of the interviews, the following issues were identified as potential obstacles to them entering the PCF market:

- All the players in the industry were expecting provisions for PCF similar to Chapter 11, but on assessment of the current provisions, they feel **the risks are too high and the returns are too low to warrant their involvement**. The market is currently unattractive, especially due to the unregulated and ambiguous nature of it.
- Currently the financiers are too scared to get involved in PCF, due to the **lack of adequate protections of their investment and the opaqueness of the current provisions**. A solution to this would be an increase in sufficient legislation or additional precedent setting PCF cases.
- As a result of the newness of the legislation, these lenders are also still **trying to understand all the provisions in the Act**, as well as all the intricate procedures of the rescue process e.g. the sequencing and prioritising of claims.
- Some parties also feel that perhaps the **South African market is simply too small** to justify the establishment of a distressed debt industry.

#### **5.8.15 Conclusion to Research Proposition Five**

The evidence from the findings clearly indicates distinct reasons why lenders are disinterested in advancing PCF. In conclusion therefore, the data supports Research Proposition Five and practitioners, financiers and management alike should consider these in order to guarantee successful PCF requests.

## 5.9 Results: Research Proposition Six - Defined stages of decline distress can be identified, which impact the success of the business rescue proceedings.

### 5.9.1 Introduction and Overall Results

The responses and data collected for this proposition were generally very varied with a few strong themes emerging regarding the stages of decline and how these impact on the ability to and the success in raising PCF as it relates to business rescue proceedings.

**Table 17** below lists some of the key aspects mentioned that need to be considered when deciding on an ideal time to file. The commentary following the table will provide more detail on the findings.

**Table 17: Summarised Elements of the stages of decline**

#	Key aspects to consider
1	Lifecycle of business / Age and maturity of business
2	Definition of financial distress
3	Warning signs and metrics to identify financial distress
4	Industry or type of business

It is evident from the table above that there was no agreement on defined stages or situations of decline apparent from the findings.

The following aspects were mentioned in general regarding the stages of decline:

- The later a business files for rescue, the larger the amount becomes that is required as PCF.
- If the business files when all the assets have already been sold off and all clients have been lost, the risk of failure is high.
- In contrast some BRPs believe that it is never too late to file if the company is able to still provide a better outcome for the creditors.
- Some interviewees mentioned that they do not believe there is a correlation between the life cycle of a business and their failure as a business.

- No reliable prediction models have yet been built to determine when the ideal time to file is in order to secure PCF and therefore a successful rescue.
- Business should have a six-monthly planning tool to analyse cash flows. This could be in the form of a cash flow budget or forecast.

Some of the major themes that have emerged from this proposition are detailed below.

The remainder of Chapter 5.9 elaborates on the above points raised, with some pertinent quotes provided by the interviewees that support the findings. Refer to **Appendix 13** for a more detailed understanding of the underlying data collected.

### **5.9.2 Life cycle or phase of business**

Some of the interviewees commented that the stage of a businesses' life cycle or maturity has an impact on the ideal time to file for rescue, and in turn the ability to raise PCF. In terms of the age or maturity of a business, some interviewees commented that businesses that are in the early years of their existence (e.g. less than 1 year) or in a start-up phase, should not file for rescue, as they have not built up any track record yet. Similarly, large businesses in the mature phase of their cycle also would not require PCF, but rather temporary distressed funding to hold them over during a tough financial time.

*FIN2: "Yes, very much so. This you would need some type of matrix to actually interpret. You have start-up businesses, you have businesses who are not in startup phase but they are probably in infancy or during their teenage years in a sense, and then you have businesses who are established. Now for all three of them on the other side you have the distressed indicators, level of distress and reason...Now in a startup phase if you get into distress it is very unlikely that you are going to raise post commencement finance. Why, probably because the funders that are currently in that particular field or who have invested in the business will not be convinced that someone else would come in and see the success of this business, because there is no track record, there is an industry or a market effect on the client so that might be another issue. But if you then take each one of the three, the startup, the infancy and the mature business you then take different factors into account...as established business in an established industry going through a decline would probably not require post commencement finance but would need maybe some distress funding from the IDC coffers.*

Some interviewees believe that a business can go into distress at any part of the life cycle, but the type of need that the business has and reason it went into distress will differ. Management therefore needs to have a clear understanding of where their business is in its lifecycle and to monitor and measure the right strategies to ensure they are aware of the warning signs.

### **5.9.3 *When is a business financially distressed***

In order to determine the ideal time for filing, interviewees commented on when a business would be defined as distressed, over and above the definition in the Act.

- The six month period in terms of the Act, when it becomes insolvent, is an important benchmark to track whether the business is financially distressed. All good business managers should have at least a six month view and proactively deal with any financial distress.
- When you cannot reach your monthly payments and commitments on an on-going basis for two to three months.

### **5.9.4 *Warning signs and metrics to identify financial distress***

A number of warnings signs or metrics were mentioned to identify financial distress:

- The business is not able to pay its salaries and key staff has left. A proposed metric is three months' salary divided by available cash should be 1:1.
- No visible inflows of cash and outflows exceed inflows, cash flow is constrained.
- Debt collection is slow.
- Lost customer base or declining volumes or selling prices.
- Summonses, Section 345 letters of demand in terms of statutory demands, litigation, judgements.
- Not paying creditors.
- Asking shareholders for more money.
- Lack of faith in the board, no board meetings, directors being bullied by one board member.
- Not making independent decisions, putting figureheads onto the board, appointing new directors who are merely there as puppets.
- Poor or declining liquidity (including all cash flows), profitability or debt ratios.

As previously mentioned, businesses in different stages of their life cycle or maturity will most likely have different distress indicators at different times. If any or more than one of these factors are visible to management, they should consider plans for imminent financial distress and potentially business rescue.

### 5.9.5 *When to file*

The interviewees indicated some guidelines, in light of the above points, about the ideal time to file for business rescue. The analogy below shared by FIN7 illustrates the main point made:

*FIN7: “If you are terminally ill to try and save somebody who is terminally ill is not going to happen, and that is how the businesses are as well. If you can see a business already there business rescue or anything is not going to help it, it is just going to go, it is just when.”*

- The earlier in the decline curve, the better; the later, the lower the chances of success. This is in order to prevent even more serious distress later down the line. The earlier a business files, the more options are available to the business e.g. divide the business, sell a part of it, create new growth in another section of the business, etc.
- The longer the wait the quicker the downward negative spiral moves. The longer the wait, the more disillusioned the stakeholders will become and the less supportive they will be in the future.

An interesting observation by FIN3 is that it is human nature to delay or deny the inevitable, but that perhaps in SA due to the uncertainty surrounding the provisions of the Act, this may be a cause for further delay in businesses filing:

*FIN3: “The issue is poor management don’t recognize the signs in the future. Also again back to the US as an example, because people have faith in the process they know what is going to happen when you file Chapter 11, they are inclined to do it quicker with more certainty and decisiveness. [CEO of Company X] didn’t really know what business rescue was about, he didn’t really know what was going to happen, it was too much of a taint so he put it off and he put it off and put it off and put it off until it was too late. So inexperienced managers are the problem in the timing of it, is the first hand.”*

### 5.9.6 Conclusion to Research Proposition Six

In closing, it is worth noting that two interviewees explained that the life cycle of a business is linked to the type of industry and sector, therefore one cannot generically look at the business lifecycles across multiple businesses and be able to make meaningful comparisons. Therefore the timing of filing and metrics used to monitor businesses must be linked to the industry. Furthermore, whether there are links between the lifecycle or maturity stage, and when the business will become distressed, is still debated. However the most important principle that emerged from the data is that management needs to have an acute understanding of the execution of business operations and strategies to be aware of any warning signs and metrics that indicate potential financial distress, and file early on while the business is still salvageable.

The following analogy by BRP7 is indicative of when a good time to file is:

*BRP7: “Ideally you should be thinking about it when it is 8:15pm, 10:30pm it is already getting late and at 11:59 it is kind of over and you know that at midnight you are going to turn into a pumpkin. So you come here and it is just way too late, it is too late.”*

In conclusion therefore, the data insufficiently supports Research Proposition Six as no clear and defined stages of decline were identified.

## 5.10 Future of PCF

The closing question posed to all interviewees was what they believe the future of PCF is, as well as what their suggestions or ideas are for the future of PCF. A summary of their responses, by interview group is detailed below.

### 5.10.1 Future of PCF

A mixed grouping of responses was received from both groups regarding the future of PCF and what is required to make it work.

- Some feel that the **quest will be a struggle unless government assists in facilitating access to funding.**
- Some BRPs hope that the **distressed investment industry will be established** before too many negative aspects of Chapter 6 are surfaced and it is potentially scrapped. There is a risk that business rescue never develops further, as was the case with judicial management, as there are currently so many problems that need to be fixed.

- Others feel that there are **great opportunities for anyone wanting to enter the market for PCF** in order to bridge the financing gap for the 25 day period in particular, and make money. Possibilities include foreign players investing in the local PCF market as well as local private equity firms. It will be interesting to note who will make the first move and who will create the first product. As the increased appetite for the development of the claims trading market expands, it will allow for the development of distressed funds over time.
- **PCF could become the domain of specialised group of individuals** who are primarily independent or potential offshoots of the major financial institutions and pull outsourcing services for practitioners. An important aspect will be to study how the industry works in other jurisdictions and learn from how they do it. **Specialised funds will be created** with particular mandates where opportunity has been identified. At the moment there is a concern that the market is not large enough for distressed debt funding.
- More **clarity needs to be provided around the legislation** to clarify all the ambiguity that currently exists, in order to provide lenders confidence concerning the consequences of them providing PCF and the certainty that they will get paid. In order for the industry to pick up, **the legislation should be changed so that PCF ranks ahead of secured lenders / creditors.**
- In time as more clarity is gained around the Act and **more precedents are created in case law**, people will become more comfortable with the system and advance money into business rescue.
- Business rescue may be more effective when it is **focussed on job saving or to rescue an industry.**
- Going forward the **bank should create products that are tailored for PCF** or funds for business rescue should be created. In time they will become more comfortable with the concept and develop an increased appetite for funding these types of entities.
- **Practitioners should be more regulated by a designated professional body.** The CIPC needs to play a more important role in this regard.

#### **5.10.2 Suggestions for the future of PCF**

These suggestions have been incorporated in the recommendations in Chapter 7.

## 5.11 Conclusion

Broadly speaking, the six propositions were supported by the data. The results from the six propositions generated aggregate results of significance and validity. The results demonstrated both support of the existing literature regarding the current status of PCF in South Africa as well as unearthing profound and unique insights delving into the deeper intricacies regarding the dynamics currently in the industry and the possible reasons why PCF is not being advanced to the expected levels.

There was strong evidence to support the proposition that there are a number of international best practice considerations for PCF. Some of these include a consultative process should be followed upfront with all key stakeholders and ensuring that PCF has a super-priority status.

It was also clear from the results that there is currently a low level of PCF of concern, with a number of specific reasons driving this. Many of these reasons are as a direct consequence of the newness of the legislation. Most of these reasons are explored in the discussion of Proposition Five.

The evidence from the findings clearly reveal a defined three phase process of PCF needs, including the timelines over which these stretch, as well as the typical financiers.

Seven main prerequisites for success were identified which correlated closely with 11 distinct reasons why lenders are disinterested in advancing PCF.

There was moderate evidence to suggest that the lifecycle stage and/or age and maturity of business could dictate when and whether it is appropriate for a business to file for rescue. Management need to keep a close eye on the typical warning signs of business rescue and ensure they file early on while the business is still salvageable.

In Chapter 6, the results from the research process in relation to the literature on PCF will be discussed in more detail..

## CHAPTER 6 DISCUSSION OF RESULTS

### 6.1 Introduction

Chapter 5 presented the results from the research process, in which six propositions derived from the literature on PCF were tested through in-depth interviews with 18 business rescue related experts (including business rescue practitioners and financiers of business rescues) in South Africa.

This chapter discusses and interprets the research findings from Chapter 5 in relation to the previous research performed on business rescue, and more specifically PCF in a South African context, as described in Chapter 2.

The research propositions and in-depth interview questions utilised in this study were informed by the body of existing literature regarding PCF in business rescue. The data coding and analysis allowed for the aggregation and refinement of the data, providing insights into the respective factors and criteria underpinning the success of PCF. The frequency ranking technique allowed for the content to be ranked according to the regularity of comments by the respondents.

Each of the six propositions tested were broadly supported by the data, with some sub-themes emerging more strongly than others. The results were both concurrent with the literature on many levels, but surfaced many new findings, and contradicted the literature on some points. Each of the propositions is discussed separately below and includes explanations of where the data overlapped and departed from previous research. From the overall research problem, the aim of the discussion of the results is to determine the current status (i.e. nature and extent) of post-commencement finance in South Africa, especially in the light of the theoretical base presented in the literature review in Chapter 2, which could lead to new insights in the field of business rescue.

The research results discussed in this chapter contribute to an enhanced understanding in respect of the theory published to date on this subject. The relevance of the results and literature in the context of this study is explored in this section.

## 6.2 Research Proposition One - Internationally there are clear prescriptives for post-commencement finance

Proposition One aimed to determine whether there are key and clear prescriptives for PCF found internationally that could be utilised as best practice principles for the utilisation and application of PCF in South Africa.

From Chapter Five Table 8, key international prescriptives for PCF were identified and will be discussed in relation to the literature, in this section.

An interesting observation to note was the fact that the role of the practitioner (or equivalent) differs greatly between the countries that were analysed. In some cases the practitioner and the liquidator are the same individual, in others cases these roles are separated. And yet again in other cases the practitioner forms part of management in a fiduciary capability, but in others they are merely a court official that manages the process. Although not investigated, this may have an impact on the success of the rescue, and more particularly the ability to effectively raise PCF. As stressed by the interviewees, UNCITRAL (2005) and the World Bank (2005) both echo the importance of PCF for the success of a business rescue in order for the business to pay for crucial day to day costs and to meet its on-going business needs.

The data supported the literature regarding the early establishment of financing requirements in order to accommodate financing needs post filing (UNCITRAL, 2005). The recommendation concerning the establishment of a “pre-packaged” financing deal prior to filing for business rescue (Gilson, 1995; Wilson & Deniz, 2008) was also reinforced strongly by the data set. This practice speeds up the process of business rescue and acceptance of the plan as all parties have negotiated terms and are in full agreement as to the plan prior filing (Gaur, 2012), as confirmed by the data.

The findings from the data however added additional considerations about the pre-filing procedures, such as conducting pre-filing feasibility assessments to determine the viability of the rescue, before any further work or consultation is done to prepare the business for filing.

The literature on the rankings and priority status of PCF is very rich with recommendations to ensure that there are strong incentives for post-commencement financiers to advance new financing to the business in distress (UNCITRAL, 2005). This would include appropriate protections for providers of post-commencement finance (UNCITRAL, 2005). These may entail the following provisions: high returns on lending for new financiers or increasing the probability

of recovering existing claims for pre-insolvency lenders / vendors (UNCITRAL, 2005); first priority claim (super-priority status) on the finances i.e. right of repayment priority (Gaur, 2012; Grace, 2012; Rogers, 2012) as well as payment of the post-commencement financier ahead of ordinary unsecured creditors (including unsecured creditors with administrative priority and fees of the insolvency representative / professional) (UNCITRAL, 2005). The findings from the data concur with all the above recommendations and therefore support the literature.

Although the data stressed that the entire rescue process is generally strictly court driven and highly formalised where specialist solvency / rescue courts approve the rescue plan and the associated PCF, only some of the literature echoed this prerequisite. The remainder of the literature predominantly stated that the courts only get involved in approving financing, when it is out of the ordinary course of business (United States of America, 2002), as the court authorises the company to incur unsecured post-petition debt or secured debt over unencumbered assets (Gaur, 2012). The only time they would intervene is when the terms are controversial e.g. where all existing secured creditors do not consent to the terms or are prejudiced (Gaur, 2012).

The one major contribution of the literature that was not explicitly mentioned in the findings as part of the international prerequisites of PCF, is that lenders usually require security to reduce the risks of non-payment (World Bank, 2005), which could include unencumbered assets or junior security on encumbered assets where there is excess value of the assets over the existing obligation (UNCITRAL, 2005). This was however later mentioned as a prerequisite for success in the discussion of Proposition Four.

An interesting recommendation in the UNCITRAL (2005) guidelines regarding security for PCF is that existing lenders' pre-commencement priority in the encumbered asset is retained, unless they agree otherwise. However, if they do not agree the previous condition may be overruled by the courts as a last resort if: (UNCITRAL, 2005, p. 119)

- (a) The existing secured creditor was given the opportunity to be heard by the court;*
- (b) The debtor can prove that it cannot obtain the finance in any other way; and*
- (c) The interests of the existing secured creditor will be protected."*

The literature also expanded on the fact that if the business should enter liquidation, it is critical that creditors obtaining priority for new funding pre-liquidation retain that priority, else it will act as a disincentive for new funding. This was not explicitly uncovered in the findings but is currently found in the Companies Act 71 of 2008, Chapter 6, Section 135 (4) (Republic of South Africa, 2008).

Although not explicitly mentioned by the literature, the data stressed that due to the maturity of the rescue law and distress investment industry internationally, the processes are more prescriptive, predictable and transparent to all parties, and therefore brings high levels of certainty and confidence for potential new financiers.

In conclusion, the data from the study largely supported the literature in identifying vital prescriptives for PCF internationally, and therefore provided evidence in favour of Proposition One. However each had unique additions to the overall literature base and recommendations for SA. These included that the data stressed that some elements appear to be more important than others (e.g. priority of the ranking and early finalisation of PCF), and that formalisation of procedures by the court is critical for consistency and clarity of processes. The literature in turn focussed heavily on the requirement for security associated with PCF, and the requirement that the priority rankings in business rescue, should be carried over to liquidation proceedings.

### **6.3 Research Proposition Two - The extent of post-commencement finance for Business rescue in South Africa is non-existent**

Proposition Two aimed to establish whether the current extent of PCF in South Africa is non-existent, and if it is, what some of the main reasons are for this. From the findings in Chapter Five, the current extent of PCF is practically non-existent, with the main reasons for this identified from Table 9.

A more in depth discussion around the reasons for the disinterest of financiers in PCF is described in Proposition Five, Chapter 6.6.

No literature was found regarding the current extent of PCF in South Africa. This is indicative of the current knowledge base around this topic. The only relevant literature that was referred to was a study performed by Vriesendorp & Gramatikov (2010) where the findings indicated that 84.7% of insolvency practitioners stated that it is more difficult to obtain financial facilities to rescue businesses in distress, following the financial crisis. The decrease in the amount of liquid financing and increase in restrictive banking regulations (e.g. Basel) would have certainly been felt in the South African market.

In terms of the nature of PCF, where it has been advanced, the findings indicated that there are various uncertainties and ambiguities in the Act regarding what constitutes PCF.

One of the items described by interviewees was whether trade creditors that continue to supply post-filing, qualify as post-commencement finance, as this was discussed in a recent local case. The literature on this matter states that should a creditor do this, the new credit is seen as an expense of the insolvency estate, which attracts a priority ranking (UNCITRAL, 2005).

Other matters, for which no literature is available, are:

- Is any financing provided post-filing deemed to be PCF, even if it is not in the plan?
  - Some insight on this is provided the definition of PCF in the Act, which says “during the company’s business rescue proceedings”, per Companies Act 71 of 2008, Chapter 6, Section 135 (1) – (4): (Republic of South Africa, 2008, p. 240)
- What is the definition of insolvent in the new Act?
- Does the six month period in the definition of financial distress also refer to the period of time in which the plan has to turn the business into a profitable and sustainable one?
  - This does not appear to be the case upon reading the definition as per the Companies Act 71 of 2008, Chapter 6, Section 128 (f) (Republic of South Africa, 2008), but is open to interpretation
- Is a controlled wind down of the business (orderly selling of assets) a successful business rescue (i.e. the business is not saved but creditors still get a better return)?

Lastly, literature on the typical Financiers of a business identified multiple parties that would meet the varying finance needs of a business. The following financiers were also identified in the findings of Chapter 5 and concurred with those listed in the literature, as the most commonly used (and known financiers) that were identified by the interviewees: Traditional Banks, Trade Creditors and Suppliers—including competitors, Distressed Lenders / Distressed Debt Financiers and Private Equity Firms.

Some additional alternative financiers identified by the literature were Asset-Based Loans, Factoring lenders, Purchase Order Financing, International Accounts Receivable, Intellectual Property Loans, Mezzanine Financing and Hard Money Lenders (Goldblatt, 2012). The data findings also identified a few other potential financiers, not explicitly mentioned in the literature i.e. Customers, Shareholders and Development Finance Institutions.

The general willingness of each of these parties to advance PCF depends heavily on the nature and disposition of the respective financier.

### **6.3.1 Trade Creditors**

The literature regarding trade creditors and suppliers propose that when there is a heavy reliance on trade creditors in business rescue, the company fails more rapidly as a result of coordination failure between many dispersed creditors and suppliers. This occurs as they can withdraw their funding, stop the supply of goods or reduce the terms of their payment; at a faster rate than banks; as their loans are unsecured and they have more to lose when a firm goes bankrupt (Tsuruta & Xu, 2007; Lin *et al.*, 2008). The literature is largely supported by the data as the creditors are typically unfamiliar with business rescue, short term focussed and would like to recover their money as soon as possible.

The data however also revealed many examples of trade creditors that were very cooperative and supportive when they valued the long term relationship with the company and / or are dependent on the goods / services. In these cases they would continue supplying and changing their terms of supply and payment to COD. Furthermore, the data added to the theory base through sharing examples of creditors and other competitors in the industry who convert their debt to an equity stake in the business or buy the business altogether to access a strategic asset or customer base.

### **6.3.2 Commercial Banks**

The findings in the data regarding banks concur with the literature in that they are very conservative lenders and risk averse (Vriesendorp & Gramatikov, 2010) that are strictly governed by restrictive regulations. Some reasons as to why they provided financing in the data, was that when they saw potential in the business and that it is it's a creditworthy entity (Goldblatt, 2012) or when their security is under threat or additional security is available (Couwenberg & de Jong, 2006). The theory builds on these reasons, providing some additional reasons why they may not be providing financing following the recent recession.

Another interesting observation from the data includes the fact that the South African banks have not created separate products for business rescue. The SA banks continue to deal with business rescue through their normal credit policies and processes and using their traditional “workout units” for this.

### **6.3.3 Private Equity Firms (“PE”) and Distressed Debt Financiers (“DDF”)**

Two promising lenders highlighted in the literature and echoed in the data, are PE firms and DDFs who have a higher risk appetite and are less regulated than banks. According to the data the attraction for them to this industry are the higher risk-return investments, buying debt or assets at depressed prices, higher payment priority in terms of the PCF rankings and potential debt to equity swaps in cases where they have identified a viable business with long term prospects. PE firms often result in a higher rate of successful turnarounds due to their long term view of the business, and hands-on management involvement.

The theory asserts that the PE industry in SA is very small and underdeveloped, but the hope is that it will be stimulated by the new debtor-friendly legislation in South Africa (van der Walt, 2006). The data concurs with this, confirming that the players are small and relatively unknown in the market, but also there is great opportunity for potential growth in this industry. The findings state the possible reasons for this are that they are still enquiring about and understanding the new industry, they are nervous about the uncertainties and ambiguities that currently exist in the legislation and therefore are not confident of their potential returns.

Another form of distressed lending identified by the findings and confirmed by the theory is the development of an active secondary market for trading in the financial claims of companies in financial distress has resulted in a number of participants entering this market (Gilson, 1995). The practice of buying and selling of distressed consumer debt at a discount from the banks is still in its infancy and will develop over time.

### **6.3.4 Private Market Lenders / Finance Companies**

A lender that was not identified in the findings but confirmed in the theory is that of private finance companies who specialise in higher risk lending. These financial institutions do not collect deposits and primarily extend credit to businesses and consumers, but are not constrained by banking regulations (Carey, Post, & Sharpe, 1998).

### **6.3.5 Customers**

An interesting atypical Financier uncovered from the data, but not confirmed by the theory, is the customer base of the business, who may value the product sufficiently to purchase a stake in the business or acquire it for their own purposes.

### **6.3.6 Shareholders**

A further potential Financier not covered in the theory is the shareholders of the business, especially if they are also serving in management/directorship positions. However in practice it is rare for them to put up security or advance financing post-filing filing due to the fact that at that late stage in the process, they have already advanced financing, and stand to lose most in a rescue or liquidation situation, due to their low rankings in the priority of repayment and low level of protection.

### **6.3.7 Development Finance Institutions**

Lastly, the findings revealed that lenders who are ideally placed to support businesses in distress, due to the nature of their mandate and key strategic social objectives, are Development Finance Institutions. Unfortunately the data revealed that the largest drawback of these organisations in advancing PCF on a timely basis is the length of time that they require to authorise financing as a result of their internal processes. Furthermore, they are also hesitant to become involved in PCF due to the blurred guidelines currently in the industry and are not intent on pursuing precedent setting cases due to the costly nature thereof.

In conclusion, the data from the study supported the literature to some extent in explaining the current extent and nature of PCF in South Africa, and therefore partially provided evidence in favour of Proposition Two. There was no literature to support the proposition that the extent of PCF in South Africa is non-existent, however the lack of literature available may be indicative of the current levels of PCF being advanced. Some ambiguities in the legislation were identified through the data and a few additional potential PCF financiers were identified through the data which are very promising for the industry. The traditional financiers described in the literature, concurred with those identified in the findings.

## **6.4 Research Proposition Three - Post-commencement finance has clear phases**

Proposition Three aimed to determine whether there are clear phases of PCF during business rescue, where specific financing requirements exist in each phase. The purpose of this proposition is to provide clarity on what vital financing requirements exist in each phase, and

therefore identify who is potentially well placed to support the business financially in each of these phases.

According to the findings from the data in Chapter Five, the three main phases of PCF are identified in **Table 18** below:

**Table 18: Review of specific finance requirements in each phase of PCF**

Phase #	Phase Name	Period	Typical sources	Purpose
1	Critical and Emergency Funding (“flash cash”, “emergency funds”)	Post-filing to first meeting with creditors	Additional shareholder loan and the company (internal cash)	To stabilise bleeding cash flows, most desperate funding required e.g. salaries, wages, and utilities.
2	Pre-Plan Approval Funding	After Phase 1 funding has been stabilised to pre-rescue plan approval (2 <sup>nd</sup> meeting of creditors). 25 days per the Act.	Trade creditors who provide extended credit terms / alternative payment arrangements; bank who extends its overdraft	To keep the business operating normally with access to some financing until the plan is approved e.g. day to day expenses.
3	Post Plan Exit Funding	After rescue plan has been approved, until business has come out of financial distress	Depends on the nature and timing of the restructuring activities	Focus on long term stabilisation and survival of the business through key restructuring activities e.g. capital expansion, new geography or product.

The findings uncovered in the data reflected certain elements of the literature that was reviewed. As such, the following inputs in terms of the stages/phases of rescue finance was proposed:

1. Upon filing for business rescue, businesses will require cash/financing to continue daily operations (e.g. salaries and wages, materials and supplies etc.) until the business plan is signed off (Burdette, 2004).

2. When the plan has been accepted, the need for cash for daily operations will continue, but in addition further financing may be required to institute the business rescue plan (e.g. capital expansion, settling outstanding debt etc.) (Burdette, 2004). The financing requirements should be detailed in the business plan (UNCITRAL, 2005).

The data adds to the literature by expanding on the activities in point 1 above. The data determines that there are two phases of financing required prior to and upon filing: i.e. emergency financing to pay critical vendors as soon as the business has filed, then once the cash flows have stabilised, the business requires financing to operate normally until the rescue plan has been approved. These two initial phases are the most challenging in terms of obtaining financing, as it is still early in the rescue process and the future viability of the business has not yet been assessed or determined. Financiers are therefore wary of providing financing in this stage, and are concerned that if the plan does not get approved, that their funding will not be recognised as PCF.

The 3<sup>rd</sup> phase is that of exist financing, which is required as soon as the rescue plan has been approved. A critical addition that the data adds to the nature of the financing required upon approval of the rescue plan, is that particularly in this phase, it would not be adhering to sound financing principles if there was provision for short term funding for long term assets. The nature of the financing must reflect the nature of the plans.

Whereas the literature determines that the leading creditor bank will assume the responsibility for funding these interim periods as well as post-commencement finance (Burdette, 2004), the data has recognised different financiers for each of the three stages/phases identified.

The data supports the literature in proposing that it is critical to determine the requirement for new financing to be made at an early stage, as early as the period between the time of filing / application and the commencement of proceedings, as well as after commencement and before approval of the plan (UNCITRAL, 2005).

In conclusion, based on the above results and discussion, the data from the study only supports the literature in some aspects of identifying key phases of rescue finances required, but provides insights into others. The data provides evidence in favour of Proposition Three, confirming that there are distinct phases of PCF required, but also provides more detail on the typical financier as well as the approximate timeframe of financing required.

## 6.5 Research Proposition Four - Prerequisites for successful post-commencement finance can be identified

Proposition Four envisages creating a list of prerequisites for the successful raising of PCF during business rescue procedures in South Africa. The purpose of this is to assist management, BRPs and Financiers alike with principles that will increase the levels of PCF experienced currently.

Based on the findings from the data in Chapter Five, seven key prerequisites for successful PCF were identified. The most critical of these identified in the data, was the **availability of security**, i.e. unencumbered high quality assets available in the business. The data reflected the international prescriptives identified in the literature regarding security, in that lenders usually require some form of security interest to reduce the risks of non-payment (World Bank, 2005) and that this may include unencumbered assets or a junior or lower priority security interest on encumbered asset where there is excess value of the assets over the existing obligation (UNCITRAL, 2005). Financiers may also provide PCF in order to protect or preserve their existing security.

This is further reinforced in the literature by way of reference made to the need for available security in the definition of PCF in the Act: “*may be secured to the lender by utilising any asset of the company to the extent that it is not otherwise encumbered*” (Republic of South Africa, 2008, p. 240).

The next crucial prerequisite for success identified in the data, was the **impact of the profile and actions of the Business rescue practitioner**. There was no literature available on this matter and is therefore a unique contribution to the literature base of business rescue in South Africa. The main aspects concerning this success factor involved the BRP’s experience in the industry, expertise, skill-set, knowledge, qualifications, reputation and track record; the effectiveness of their networks and relationships in the industry; the ability to make a thorough assessment of the business and to convert this into a high quality rescue plan and lastly the ability to persuade and sell the business to the stakeholders.

The third most critical success factor, which concurred with the literature regarding the willingness of creditors to lend only to creditworthy companies (Goldblatt, 2012), elaborated on the fact that financiers require a **comprehensive and sustainable plan based on a viable business with a sound underlying business model**. These elements are complemented by a competent management team.

Critical success factor number four supports the literature on **upfront engagement with financiers (and any other major stakeholders), prior to filing for business rescue**. The main purpose of this is to collaboratively obtain buy-in from key stakeholders early on in the initial assessment of the business, to finalise the proposed plans as well as gauge the financing need and their appetite for PCF (UNCITRAL, 2005). A further recommendation was that the international practice of a “pre-pack” agreement for financing should be agreed amongst the key stakeholders (Gilson, 1995; Wilson & Deniz, 2008). This aspect was also echoed in the international prescriptive for PCF. Concerns were however raised that this may lead to the compromise of the independence of the BRP, under current practice and law in Chapter 6 of the Companies Act of 2008.

The fifth critical prerequisite for PCF identified from the data, was the requirement for distressed businesses to **file for business rescue much earlier than they currently do**, in order to increase the likelihood of obtaining PCF. The company should be guided by the six month time frame defined in the Act in order to give the BRP more time to secure and ensure the business is in a healthier financial position with more available security. This furthermore erodes the Financier’s trust in management. These findings have added to the literature on PCF.

The last two prerequisites for success were both also unique additions to the literature, based on the findings in Chapter 5. They related to the state of the relationship of the financier with management and the existence of another financial backer or buyer in the business rescue.

It is critical that **management has an open and transparent relationship with their financiers** in general but also throughout the business rescue proceedings, in order to gain or maintain the trust and comfort that the Financier has in management and the business.

Furthermore, the findings indicate that **should another party volunteer financing during rescue proceedings banks would be more likely to advance PCF**.

Two key aspects stressed by the literature, that were not validated in the findings, are the positive impact that pooling of creditors during rescue has on the ability to raise finance (Brunner & Krahn, 2001) as well as of cooperation and communication between lenders and borrowers when a company is distressed (Adiecha, 2012).

In conclusion, based on the above results and discussion, the data from the study partially supports the literature but adds greatly to the insights on the key prerequisites for successful PCF. Therefore the data provides rich evidence in favour of Proposition Four, confirming that

there are prerequisites that could be applied by all parties to ensure the securing of PCF on a more regular basis.

## **6.6 Research Proposition Five - The reasons for lenders' disinterest in post-commencement finance are clear**

Proposition Five aimed to determine whether there are reasons for lenders' apparent disinterest in PCF, in light of the view in Proposition Two that PCF in South Africa is non-existent. The purpose of identifying these reasons would be to determine whether there are any recommendations that could be provided to management, BRPs and Financiers alike regarding the strategy that should be followed to stimulate the interest in funding for distressed businesses.

Based on the findings from the data in Chapter Five, eleven key reasons for lenders' disinterest in PCF were identified.

The first six findings are directly correlated inversely to some of the prerequisites for success identified in Proposition Five. Therefore the discussion of these will not be repeated but any additional insights will be signalled.

### **6.6.1 *The impact of the profile and actions of the Business rescue practitioner (ranked # 1)***

Practitioners are incorrectly placing companies in business rescue or calling for an end of the rescue too late either because they do not have a sufficient understanding of the processes or they are trying to earn unwarranted practitioners' fees. Following on from this item, it has been observed that BRPs take on too many cases at a time, which results in them not devoting sufficient time on each rescue case.

Lack of regulation of BRPs was a major concern for all stakeholders. There is currently no regulator that actively manages the conduct of the BRPs and no core body that accredits practitioners for appointment to rescues. This has affected the quality of the BRPs produced that are assigned to cases. Another concern that was raised from the data was the defining which appropriate profession(s) that would make an individual eligible to qualify as a BRP.

Upfront assessment of the BRP has once again been mentioned as a void in the current rescue cases; however the debatable concerns over the independence of the BRP may moot this suggestion. Alignment of the Act and the industry practice on this matter with international best practice is recommended.

#### **6.6.2 *Business rescue filing by distressed businesses for wrong purpose and too late (ranked # 2)***

In addition to the early filing requirements, it is critical that businesses file for rescue due to them being a true business rescue case and not a liquidation case which is purposively being delayed. Unfortunately continued abuse of the system has occurred and companies file merely to benefit from the moratorium on claims. Part of the reason for this is that companies are often ill instructed by their advisors. Due to the late filing, possible alternative solutions from their financier have also been lost.

#### **6.6.3 *Distressed business should involve and engage Financiers upfront prior to filing for business rescue (ranked # 8)***

The data observed that if neither management nor the BRP contact the Financier upfront prior to filing, and merely serve the bank with a notice of filing, the company is almost guaranteed to not receive PCF from bank, as they have destroyed their trust and damaged the relationship with the Financiers.

#### **6.6.4 *State of the relationship of financier with management and the BRP (ranked # 9)***

Following on from the previous factor where the relationship between the management and financier was stressed, the interviews revealed that the lack of PCF is not so much a factor of disinterest in financing, but rather one of distrust in the situation and the management team.

#### **6.6.5 *The availability of security (ranked # 10)***

The interviewees were unanimous in their opinion that should there not be any unencumbered security, it is highly unlikely that they will be able to obtain financing. This is especially so where a Financier loses the security they assumed they had.

#### **6.6.6 *Financiers do not have comfort in the rescue plan based on a viable business (ranked # 11)***

No additional insights were raised.

The next five findings were new insights that were raised regarding the reasons for disinterest from financiers.

#### **6.6.7 *Business rescue culture and perceptions of business rescue in South Africa (ranked # 3)***

No literature was identified relating to the rescue or general business culture in South Africa. Therefore the following insights that emerged strongly from the data could be added to the knowledge base for understanding PCF in SA.

The concept of a corporate rescue culture in SA is still very new and therefore it will take a long time to change the mind-set and culture from a traditionally creditor-friendly one, to an institutionalised debtor friendly one reflected in the international rescue arena. Actions to encourage this have included keeping the legislation outside of the entrenched Insolvency Act. However, due to the harsh penalties that still exist for failed businesses and directors; the change management process will be long and difficult. The additional aspects of the general SA business culture of mistrust and dealing with uncertainty, as well as the relative immaturity and small size of the business market, also makes the change even more challenging.

#### **6.6.8 *Concerns and uncertainty regarding the priority ranking of PCF (ranked # 4)***

The findings regarding the priority ranking of PCF exposed the concerns of many interviewees, as the current ranking in the Act could be seen as a disincentive for new financiers to advance PCF. Interviewees expressed confusion with regards to the seniority of PCF. The current understanding is that PCF is not a super-priority claim ranked above all other lenders and creditors, as is the case in the international legislation. This was particularly so for new Financiers who would be ranked after secured creditors and therefore have a higher probability of not retrieving their money, if secured financiers utilise all their security to repay themselves. This means that they only just rank ahead of unsecured creditors, which indicates that their level of priority does not reflect the risks that they are taking (and expected rewards) in advancing PCF during business rescue.

The powerful position of the secured creditors generally results in them being uncooperative in rescue proceedings and not being in favour of the plan. The reason being that in almost every eventuality, they would compromise their security if the rescue were to proceed. There also appears to be uncertainty with regarding the priority of taxes that are unpaid or Insolvency Act preferences.

Upon referring to the literature extracts from Section 135 of Chapter 6 of the Companies Act of 1973, it can be seen that no mention is made of the position of secured creditors or unpaid taxes. There is uncertainty surrounding the ranking of secured pre-business rescue lenders.

#### **6.6.9 *Banks are conservative and risk averse due to regulations such as Basel (ranked # 5)***

The data from respondents strongly reflect the fact that banks are by their very nature risk averse and stringent with their lending, as echoed in the literature by Goldblatt (2012) and Vriesendorp & Gramatikov (2010). This has been further exacerbated by the recent financial crisis which has resulted in banks making their lending standards austere (Goldblatt, 2012).

The literature explained that following the credit crisis, the world has moved to more restrictive banking regulations and policies both locally and internationally (e.g. Basel Framework) and increased expectations that the banks be more prudent (Vriesendorp & Gramatikov, 2010). The data supported this by stating that banks operate in a highly regulated environment and are restricted from lending to certain categories of high risk clients, through capital reserving requirement formulas from regulations such as Basel with which they need to comply. Incorporating Basel and other bank policies for a “high-risk” client such as a distressed company would make the pricing of financing, to incorporate the associated risk, unaffordable and unfeasible.

The exceptions to the rule for when a bank may advance financing, as uncovered by the findings in the data, is in certain exceptional circumstances where offshoots or divisions of the bank may buy equity stakes in certain businesses as a means of providing funding.

#### **6.6.10 *Financier risks losing money (ranked # 6)***

A commonly shared cliché from the interviews is that banks have a policy of “my first loss is my best loss” and they would rather exit than invest and risk losing any more money. As mentioned

before, banks are generally very risk averse and very loathe to losing any money that they have advanced. One of the reasons for their concern is that as soon as another party advances PCF this may potentially dilute the return that creditors will receive in business rescue, and eventually make liquidation more attractive. Therefore it becomes a further reason for why financiers are disinterested in business rescue and therefore PCF. Financiers are generally more interested in funding healthy businesses that can provide them with asset growth, positive returns and assurance of payback, rather than channelling more money into a declining business, surrounded by uncertainty and the likelihood of a write off.

A further debated issue in the industry is the situation where the bank has cession of debtors as security, and where the bank takes receipt of any of the funds from collection of these debtors. However, in practice the BRP uses all incoming cash flows to pay certain commitments to other creditors, which the banks argue is then part of their contribution to PCF.

#### **6.6.11 Lack of cooperation by banks during business rescue proceedings (ranked # 7)**

The final factor that emerged strongly from the data was that many BRPs perceived the conduct and actions of banks during business rescue as unhelpful and uncooperative. The responses indicated that regardless of the merits of the case, the banks are not in favour of business rescue and therefore unlikely to advance PCF. They were described as “not playing ball” and only looking after their own interests, which often results in them more than likely allowing the business to fail in order to receive a perceived better return in liquidation.

Although banks have indicated that their clients should engage in upfront communication regarding assistance before filing for rescue, the experience has been that when this is done, the bank’s response is to call up the overdraft facility. Banks shared that they are still scared to get involved in business rescue at this stage, and see these clients in distress as “problem children”, as well as not seeing the practice of distressed lending as one of their core focus areas. They also communicated that due to their concerns regarding business rescue, they tend to take a firmer stance on provision of funding and on extensions of deadlines for the rescue plan.

In contrast, a view was raised that ultimately the banks are profit driven and accountable to shareholders and therefore need to invest in ventures or transactions that can offer a positive return for shareholders.

As Distressed Lenders are seen by many in the industry as the ideal future post-commencement financiers, it is important to understand their reasons for not yet actively participating in the distressed lending market. These were described in Chapter 5.8.14.

Finally, other factors that were mentioned as reasons for lenders' disinterest in PCF were described in Chapter 5.8.13, that include:

- Lack of Regulation of Industry
- Distrust in the business rescue system and degree of opaqueness in the interpretation of the Act.

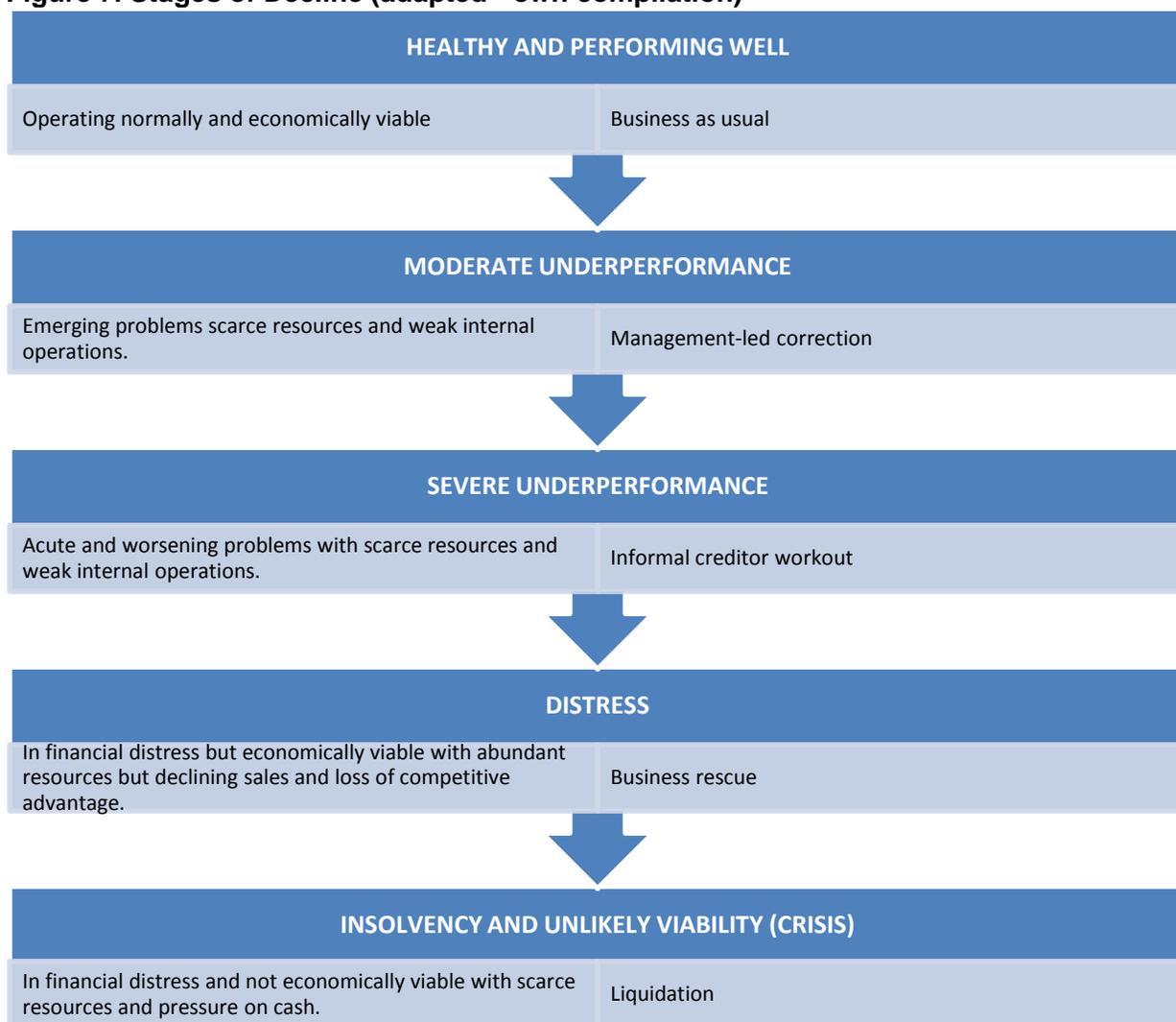
In conclusion, the data from the study largely supports the literature but adds significantly to the understanding of the reasons for the low level of activity observed around PCF. Therefore the data provides extensive evidence in favour of Proposition Five, informing the literature of factors that inhibit PCF in the South African business rescue environment.

## **6.7 Research Proposition Six - Defined stages of decline can be identified, which impact the success of the business rescue proceedings.**

Proposition Six aimed to test whether there are defined stages of decline (financial distress) which are identifiable and which are indicative as to the ideal stage of filing for rescue, and therefore could indicate the likelihood of raising PCF.

The literature available about the stages of decline propose a timeline of financial distress in Table 1 of Chapter 2 (Corporate Renewal Solutions, 2011b) as well as four stages proposed by Pretorius (2008). These have been combined to propose a high level timeline of the stages companies go through when in financial distress or in a turnaround situation. The timeline consists of four main stages and a brief diagnosis of each phase. The trigger for a business may go into distress is usually aligned with the guidelines for financial distress defined in the Act; i.e. six months period where the business cannot meet the financial commitments.

**Figure 7: Stages of Decline (adapted - own compilation)**



The data findings were random and inconclusive in supporting the literature, with the main themes that emerged (detailed in Table 13) centering on the links between decline and lifecycle, size or maturity of a business and warning signs and metrics to identify financial distress.

Interestingly, some of the interviewees stated that the stage of a businesses' life cycle or maturity has an impact on the ideal time to file for rescue, and in turn the ability to raise PCF, whereas others believed that there was no correlation and that a business could go into distress at any part of the life cycle.

It is therefore important that management have a clear understanding of where their business is in its lifecycle and monitor the warning signs of imminent decline. An observation was also made that the stages of decline or distress is also very dependent on the industry or type of business.

In conclusion, the data and findings from the interviewees did not sufficiently support the literature, indicating either that the concept is not important in the understanding of PCF, or the industry has not yet identified the potential correlation between the stage of decline and advancement of PCF. This can be considered to be an area for further research in this field. The data does not provide evidence in favour of Proposition Six.

## 6.8 Conclusion

Insights regarding the availability of PCF and criteria to ensure that it is successfully raised, were effectively gleaned from the 18 respondents, and were very rich and dense. A new, fresh understanding of the business rescue landscape in South Africa has been uncovered.

The overall findings showed not only that there are prerequisites for PCF to be found internationally, as explained in the literature, but that there are many key success factors to be found locally in order to ensure the successful implementation of business rescue proceedings.

There are a host of factors that will influence the extent of PCF and these can be summarised broadly as follows: early engagement with key stakeholders and a pre-assessment of the business is critical to identify the nature of funding required as well as the obtain commitment for financing from proposed lender. The priority status of PCF is crucial to attract financiers, but this needs to be supported by sufficient and available security, a sound rescue plan and a sustainable business model. The role of the BRP is crucial in all of these steps, as he has to build credibility, confidence and trust with all key parties in order to win their support and persuade them to believe in the future potential of the business. Open, regular and transparent communication is inherent to all dealings described.

Each of the six propositions tested were therefore broadly supported by the data, with the exception of Proposition Six and with some notable contradictions and additions. The outcomes for management of businesses, BRPs and Financiers are significant and noteworthy.

Finally, the data was largely supportive of the literature on both on PCF and related and prerequisites. However the data added to the literature by highlighting that the overall extent PCF is non-existent but in addressing particular success factors and disincentives, this situation may be rectified.

A large amount of the reasons for the current failures in raising finance, are symptomatic of the fact that the legislation is barely 18 months old, and has not had sufficient time to settle, mature and develop into concrete guidelines and processes.

The next chapter will briefly look at the background to this particular research problem and the objectives that were set at the start of this research project, before summarising the main findings, outlining some recommendations to business, considering the limitations of the research and the implications for future research and finally providing a conclusion to the research report.

## CHAPTER 7 CONCLUSION

### 7.1 Introduction

The previous chapter discussed the research findings in the context of existing literature on business rescue and PCF. This chapter briefly reviews the background to the research problem and objectives set at the outset of the project, before summarising the main findings and then presenting the “Primary influencers of PCF” framework. This framework is presented as a result of the findings and insights gleaned from the respondents, as discussed in Chapter 5 and Chapter 6.

Recommendations to business / practitioners / financiers / government are then outlined based on these findings, considering the limitations of the research and the implications and recommendations for future research are then discussed, followed by a conclusion to the research report.

### 7.2 Research background and objectives

In light of the recent global financial crisis and subsequent economic recessions and downturns, as well as the observation of an increase in liquidations and insolvencies of businesses in recent years, the topic of corporate renewal and rescue has gained importance. The South African Department of Trade and Industry responded to this climate in 2011 by implementing business rescue legislation based on international corporate rescue principles, in the new Companies Act 71 of 2008 through Chapter 6: Business rescue and Compromise with Creditors.

However, the recent, publicised rescue failures, together with recent research published on business rescue (Pelser, (2012) & Pretorius (2012)), suggests that the lack of PCF is one of the top five reasons why business rescues in South Africa (and abroad) have failed.

The research problem identified was based on the perceived low levels of PCF advanced during business rescue in South Africa. An investigation was required into what the current status (i.e. nature and extent) of post-commencement finance is in South Africa.

The objective of this report, therefore, was to explore the reasons for non-existent PCF, through identifying the reasons for lenders' disinterest in financing distressed businesses, as well as associated critical success factors, within a South African context.

Subsequently, the aim of this study was met, having described the nature and extent of PCF in South Africa, identifying the reasons for the current extent and proposing best practice to secure PCF successfully in a South African context. The main findings are summarised in the following section.

## **7.3 Main Findings**

Eighteen in-depth expert interviews were conducted with practitioners and professionals within the business rescue and financing industries, in order to test the propositions that were derived from the literature review. This research combined the foundation literature that has preceded it and integrates the findings with new knowledge and understanding uncovered through the interview process. Respondents revealed deep wisdom that linked directly to the six propositions presented in Chapter 3.

The research findings presented in Chapter 6 are mostly consistent with the existing literature. However, this study contributes to the broader theory and expands the subject by discussing the complexities in the PCF landscape as well as current best practices identified in the field in a developing country context.

During data collection, most interviewees stated that the current extent of PCF in SA is little to none. This was a concerning fact due to the major influence the ability to successfully raise PCF has on the overall successful outcome of a business rescue. The key findings comprehensively discussed below provide reasons for the lack of PCF as well as success factors to consider for raising PCF in the future.

### ***7.3.1 Critical pre-filing procedures: Early consultation, viability assessment and pre-packaged financing***

The first contribution relates to all the critical pre-filing procedures that are required to take place to ensure a higher probability of securing PCF. These elements seem to not have received the attention they deserve in the literature, but serve as a rich all-inclusive theme for the overall findings of the research interviews.

The key messages emerging from these findings stress that in order for PCF to be raised successfully, some critical processes need to be followed prior to a business filing for rescue. These include upfront consultation and collaboration with key stakeholders (especially Financiers) in order to advise them of the situation, discuss alternatives and options and therefore ensure the buy-in from all parties prior to filing. It is also critical for the BRP to perform a viability assessment prior to accepting the engagement and prior to filing, in order to determine whether the company is an appropriate case for business rescue. Lastly and most importantly, as a result of the above two steps, the future post-commencement financier should be identified, and consensus obtained early on regarding the nature, timing and extent of PCF. All three of these findings form part of the international prescriptives and best practice for PCF.

### ***7.3.2 The impact of the newness of the legislation: lack of understanding and awareness, deficiency of case law and legal precedents as well as companies incorrectly filing***

The second contribution of this study relates to the immense impact of the nascent legislation, and the subsequent effects on the lack of knowledge about the law, the severe deficiency of legal cases to guide interpretation of the Act, as well as the wrong companies filing for rescue due to the previous two factors.

The absence of sufficient awareness, knowledge and understanding of business rescue has resulted in many players being reticent of participating in the industry due to the many loopholes and inefficiencies that still exist in the law, and the interpretation thereof. The current perceptions of business rescue further propound its perceived ineffectiveness. This has been exacerbated by the scarcity of case law and legal precedents which creates uncertainty in the industry. Furthermore, business rescue is an expensive process for the different players to pursue and test. This factor also forms part of the international prescriptives and best practice for PCF.

Thirdly, companies file too late in their distress timeline, when all possible turnarounds are rescue options or efforts would have already been exhausted already. Financiers are generally only interested in companies who still have a viable business model in place with potential and realistic future prospects. The previously creditor-friendly culture in South Africa will also take a long time to change to a debtor-friendly culture, with the focus on corporate renewal, rather than solely protecting the interests of creditors.

Lastly, as a result of the above three factors, it has been observed that many businesses that should not be filing for rescue (due to their size or them being more suitable for liquidation) are doing so, mainly as a delaying tactic. Much of this has to do with these businesses either abusing the moratorium or receiving incorrect advice from financial and legal advisors.

All of these factors unfortunately erode the trust of the financiers. A relationship of trust, openness and transparency with management and the BRP are critical for the confidence of the financier in the distressed business.

### ***7.3.3 Ambiguities in the legislation and uncertainties in the industry***

A direct consequence of the previous factor gives rise to the third major contribution of this study. A host of ambiguities and opaqueness has been identified in the Act which gives rise to uncertainty in the interpretation of the Act e.g. the definition of PCF, the definition of insolvent, the ranking of priorities, what constitutes a successful business rescue, etc.

A crucial concern that was raised in the findings is the fact that PCF in the local legislation is not classed as super-priority status in debt rankings. This criterion is a key requirement in the international prescriptives and best practice for PCF. Without this provision, there is little incentive for non-traditional financiers (e.g. distressed lenders or private equity firms) to advance funds, as the risk is too high and the returns too low.

Furthermore, the lack of regulation of the industry, and more specifically the management of the BRP as a profession, is concerning for all stakeholders and causes a distrust in the system. It is therefore critical that these aspects are clarified in order to provide potential financiers with confidence to participate in the industry, as well as certainty that their funding will be recognised as a higher priority debt.

### ***7.3.4 The availability of security and related losses for financiers***

The fourth major contribution sheds light on a critical factor that is almost a failsafe criterion for a business to be able to raise PCF i.e. the extent of unencumbered assets available as security for the financier. This is a critical non-negotiable for almost all (traditional) Financiers to provide PCF, as it provides them with the certainty that they will be repaid and / or not lose a substantial amount of their debts if the business is liquidated.

Therefore Financiers may also advance funding in order to protect or preserve their existing security as well as to increase their level of confidence of and certainty of being repaid. Non-traditional financiers are typically interested in the value and commercial viability of additional financing provided, at attractive returns.

### **7.3.5 *The role of the BRP on the ability to raise PCF: experience, knowledge and ability to prepare a sound rescue plan***

The fifth significant contribution presented by this study is the significant impact of the role of the BRP on the ability of the distressed business to obtain rescue financing. It was evident from the findings that an experienced BRP with collaborative networks and a thorough understanding of the business rescue provisions and associated industry, is much more effective at raising PCF than a BRP who does not possess these qualities.

An apparent impact of the above is the effect that this has on the quality and soundness of the rescue plan presented to creditors. In practice the rescue plans are unsustainable and not based on a viable business. Lack of accurate and reliable information also further aggravates the problem.

### **7.3.6 *Dominant (and potentially adverse) role of the banks***

The sixth contribution of this study pertains to the impact that banks have had on the ability of BRPs to raise PCF. Due to the fact that the bank are usually the major creditor (with a majority vote) during business rescue proceedings, they often have significant influence on the outcome of the rescue plan, PCF raised and ultimately the success of the business rescue. They have been perceived as too conservative and risk averse and therefore not cooperative during proceedings.

They will also seldom provide financing, unless another financial backer or potential buyer of the business has already committed to the distressed business.

Some of the reasons provided for this are that due to the highly regulated industry in which they operate, they are uncompromising and unreasonable during PCF negotiations; they always want to make sure they do not lose any money or dilute their security, nor lose control of the process, and that no other creditor is better off than them.

## 7.4 Recommendations for stakeholders

The findings from all six propositions provide useful insights for businesses, practitioners and financiers operating in, or considering operating in the business rescue industry.

The recommendations made are based on what has been observed as currently working well within the industry, as well as new recommendations that have been identified. These have been divided into recommendations for management of distressed businesses, BRPs, Financiers and lastly government institutions associated with business rescue.

### 7.4.1 *Business (i.e. Directors and Management of Distressed Businesses)*

Some critical recommendations emerged for the management of a distressed business which would dramatically increase the success rate of business rescues overall, as well as positively impact the willingness of financiers to provide PCF. These recommendations include having a long term view on business rescue and the company's financial health and being very familiar with the lifecycle of business in order to identify distress warning signs early on. As soon as the company realises that they are in financial distress (utilising the six months definition according to the Act), they should involve and engage financiers early on regarding the distress and therefore if warranted, file for rescue early while the business is still saveable. During this consultation with financiers, pre-arranged financing can also be secured. If this process is followed, there will more than likely be sufficient security available to financiers, and will demonstrate proactive, open and transparent communication, which will encourage the raising of PCF.

### 7.4.2 *Business rescue practitioners*

BRPs play a crucial independent facilitator role during business rescue proceedings and should therefore ensure that their actions and profile at all times builds confidence with key stakeholders, but particularly those of the financiers. Some of these key aspects include ensuring that they do not take on appointments if they are not suitably qualified to perform the rescue. Before they do take on an appointment, it is important to perform a viability assessment upfront before taking on the case. Following which it is a favourable assessment, the laws and regulations in the Act should be meticulously followed. It is also important to ensure that the BRP does not take on too many appointments at any one time, as he / she will not be able to

perform a thorough analysis and high quality rescue plan if overloaded. Should they adhere to all of these principles, they will build a relationship of trust and openness early on with all creditors.

### **7.4.3 Financiers**

Financiers are generally the most important party in a rescue, due to their ability to influence the approval and adoption of the rescue plan. Key recommendations to them include assisting to produce more successful rescue cases, to create specialist business rescue products and teams in order to service this new industry, to be more cooperative during business rescue proceedings and to ensure a thorough understanding of the legal aspects of Chapter 6.

### **7.4.4 Government (i.e. DTI, CIPC, IDC, DBSA etc.)**

As a result of the newness of the Act, many ambiguities and uncertainties have been identified in the provisions of Chapter 6, which need to be clarified in order for the industry to prosper. These include clarifying these matters raised above through a mechanism such as a Practice Notes (or equivalent) to provide insight into how to interpret the law e.g. independence of BRP if he performs a pre-assessment upfront. Also, the ranking of PCF needs to be elevated to super-priority status in order for financiers to be incentivised to provide new rescue financing in a distressed business.

Unanimous feedback received from most interviewees was that the industry needs to be more regulated, particularly with regard to the management of BRPs, and the entire process should be a strictly court driven process with highly specialised courts judges.

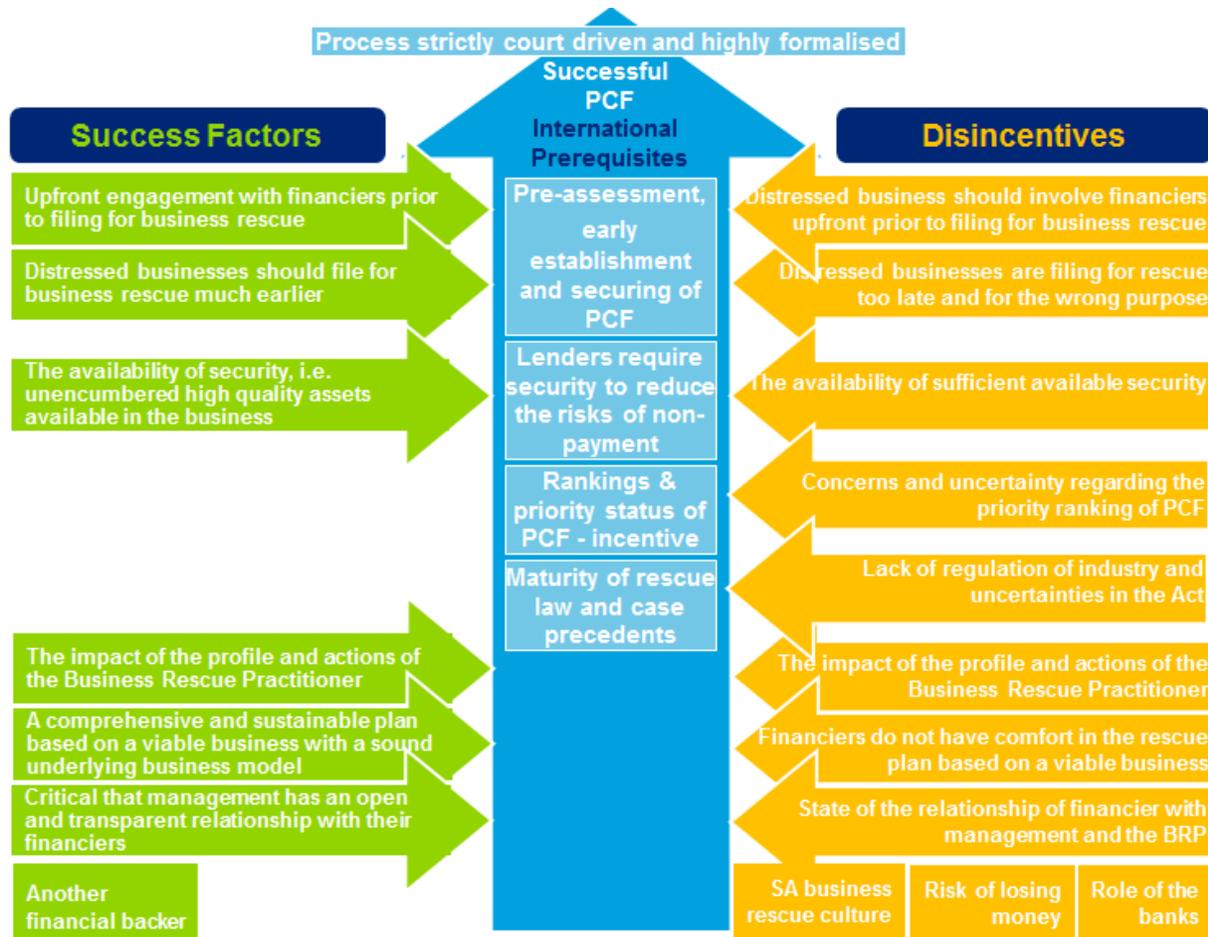
Lastly, a need was expressed for a distressed fund to be created through the IDC / DBSA, which is easily and rapidly accessible to BRPs and/or approved commercial banks.

## **7.5 Proposed Framework: Primary influencers of PCF**

The primary influencers of PCF framework is presented as a model illustrating the key success factors that promotes PCF as well as the disincentives that influence PCF negatively in South Africa. There is an overlay with the key international prescriptives for PCF. This framework can

be used by management, BRPs and academics alike to increase the probability of the occurrence of approved PCF.

**Figure 8: Primary influencers of PCF (own compilation)**



Key:



## 7.6 Limitations of the research

All the findings above are limited by the fact that qualitative research can only be generalised to theory rather than to a population. In order to test the findings and the theories that emerged from the research, quantitative research should also be conducted.

It should also be noted that the theories and frameworks generated by this research are purely descriptive. They provide a snapshot of what is currently happening, based on the expert opinions and information provided by business rescue practitioners and financiers. This research did not seek to test constructs against outcomes, nor to provide a blueprint for how the raising of PCF should happen; but rather aimed to simply provide a description of how PCF currently happens. For a blueprint that would offer best-practice guidelines and recommendations for companies, an explanatory study—either quantitative or qualitative—would need to be conducted to surface causal links between certain actions, decisions or behaviours, and certain outcomes.

Another key limitation is the fact that the population was defined as all South African experts in the field of business rescue and turnaround who possess the necessary experience and knowledge in the field, due to the place of origination of the legislation being researched as well as the researcher's location. While findings in South Africa may be useful to other countries looking into PCF or corporate renewal legislation, the findings are limited to the provisions of a particular country's insolvency or rescue legislation. The location of the sample (mainly Gauteng and Western Cape based) may have prejudiced certain findings and may not be replicated to other contexts.

Another potential limitation is the bias in the sample toward experts within the researcher's broader network.

From the discussion of the results, a number of questions for future research were extracted and are summarised in the next section.

## **7.7 Recommendations for Future Research**

The topic of this research is relatively new in academic terms and consequently, the choice of research design has been an exploratory in nature. Therefore the research has focused on building theory, rather than on testing that theory. Future avenues for research might include an explanatory study utilising either qualitative or quantitative methods, and utilising real-life business rescue case studies that have been completed (successful or not) since May 2011.

The research project has been aimed at uncovering insights regarding the current PCF levels and best practice principles to ensure success. Future research may be useful to confirm and validate the findings of this research.

Furthermore, this research project was based on interviews with 18 experts in the practitioner and financier fields. Further research may be important to elicit responses from a broader sample of management or directors of distressed businesses that may have a different and perhaps more practical perspective regarding the dilemma under review.

Further areas for research are suggested below:

- The impact of the role of the BRP on the success of the business rescue proceedings. This would include compiling a list of behavioural traits, key experience required, requisite knowledge of the industry and business rescue proceedings, impact of personal and professional networks, as well as any other pertinent factors.
- The role and impact of Development Finance Institutions on the success of business rescue turnarounds.
- Further research that could be performed on the international prerequisites for successful business rescue, include considering the following aspects:
  - Include a range of other countries that have business rescue regimes, to include in the benchmarking process followed.
  - The crucial (legal or other) triggers of business rescue, and the ultimate deciding factors to terminate proceedings and enter liquidation.
  - The exploration of different roles and capacities of the BRP in different jurisdictions was completed, but further research could be performed on the impact that these differing roles have on the ultimate outcome of a business rescue.
  - Investigating the impact of the business and rescue culture on the success of business rescue in different countries.
- The correlation between the life cycle of a business and the stage of decline in which the business rescue occurs.
- The impact of the size and maturity of the private equity and distressed lending market on the ability to raise PCF as well as the ultimate success of business rescue. The major driving and inhibiting factors could be identified.
- The World Bank (2005) identified that an informal out-of-court rescue process is often more sustainable and successful than in a formal rescue regime. The merits of this statement could be analysed and debated utilising case studies across different jurisdictions.

## 7.8 Conclusion

As businesses continue to compete in a global village, where they are exposed to the “sneezes” from the major players in the world marketplace, they will continue to embrace the many opportunities open to them, but also face many challenges and struggles in trying to remain competitive in this new context. The credit crunch and subsequent recession are past events, but these factors alone do not leave businesses vulnerable to future global shocks. The important thing for modern day businesses to cultivate is the resilience required to weather these storms, but more importantly to build the good principles of corporate renewal, business rescue and turnaround into their DNA.

This requires businesses to take a long-term view on the financial prosperity of their business by recognising the signs of financial distress and grasping the formal legal tools available to them to avoid liquidations.

The SA business rescue legislation is one of these tools, and aims to support businesses in financial distress, but to date it has had limited success since its recent enactment. Consensus is that the legislation itself and the purpose thereof is sound, however the interpretation and implementation thereof result in the inability of businesses and practitioners to raise PCF, and ultimately business rescue fails as a whole.

The legislation has enormous potential to support the Government of SA in achieving their macro-economic and social goals for the country, by reducing the instances of liquidation and business failures and thereby safekeeping the country’s levels of employment. Some fruits of these successes have already been seen to date, but these are few and far between. Unfortunately, the media’s headlines are still dominated by major local organisations filing for liquidation.

Companies, BRPs, Financiers and Government alike should offer collective support to facilitate and promote the development and stimulation of this crucial corporate renewal industry. This can be done by taking cognisance of the recommendations outlined for each party in this study, as well as by utilising the “Primary influencers of PCF” framework proposed.

It would be naïve to believe that the road to an established and successful business rescue industry will be without its challenges and constraints, however the most visionary players will

view these not as inconveniences to overcome but rather embrace these as opportunities to leap ahead of competitors and carve out competitive advantage.

*“A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty.”* Winston Churchill

## REFERENCES

- Adiecha, P. (2012). Managing lender communications during financial distress. *Journal of Corporate Renewal*, 14-17.
- Australian Government. (2005, March 2). *Corporations Act 2001*. Retrieved April 14, 2012, from Commonwealth Consolidated Acts:  
[http://www.austlii.edu.au/au/legis/cth/consol\\_act/ca2001172/](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/)
- BBA. (2004, February 16). *London Approach*. Retrieved September 7, 2012, from BBA:  
<http://www.bba.org.uk/policy/article/london-approach/fx-and-money-markets-policy/>
- Beck, T., Demirguc-Kunt, A., Laeven, L., & Maksimovic, V. (2006). The determinants of financing obstacles. *Journal of International Money and Finance*, 932-952.
- Belting, J. (2008, May 11). *Empirical Methods: Expert Interviews*. Retrieved July 6, 2012, from [http://www.oat.ethz.ch/education/Autumn\\_term\\_08/Material\\_on\\_Empirical\\_Methods/Expert\\_Interview.pdf](http://www.oat.ethz.ch/education/Autumn_term_08/Material_on_Empirical_Methods/Expert_Interview.pdf)
- Bibeault, D. B. (1999). *Corporate Turnaround: How Managers Turn Losers into Winners*. Washington D.C.: Beard Books.
- Bracewell & Giuliani. (2012). *International and Comparative Corporate Insolvency Law*. Retrieved August 23, 2012, from University of Connecticut School of Law:  
<http://evanflaschen.net/Chapter%2011%20Overview.pdf>
- Brunner, A., & Krahen, J. P. (2001). Corporate Debt Restructuring: Evidence on Lender Coordination in Financial Distress. *Center for Financial Studies Working Paper No. 2001/04*. Frankfurt.
- Burdette, D. (2004). The development of a modern and effective business rescue model for South Africa. *Pre-Consultation Working Document*. The Centre for Advanced Corporate and Insolvency Law - University of Pretoria.
- Carey, M., Post, M., & Sharpe, S. A. (1998). Does corporate lending by banks and finance companies differ? Evidence on specialisation in private debt contracting. *The Journal of Finance Vol LIII, No.3*, 845-878.
- CIPC. (2012). *LSSA / UNISA Workshop 21 September 2012*. Johannesburg: CIPC.

- Cork, S. K. (1982). *Report of the review committee in insolvency law and practice*. Retrieved November 5, 2012, from <http://discovery.nationalarchives.gov.uk/SearchUI/details?Uri=C11294862>
- Corporate Renewal Solutions. (2011a). *Turnaround funding and financial restructuring*. Retrieved April 17, 2012, from <http://www.turnaround-sa.com/turnaround%20strategy/turnaround%20funding.php>
- Corporate Renewal Solutions. (2011b). *Turnaround Management*. Retrieved April 22, 2012, from Corporate Renewal Solutions: <http://www.turnaround-sa.com/timeline%20of%20financial%20distress/timeline%20of%20financial%20distress.php>
- Couwenberg, O., & de Jong, A. (2006). It takes two to tango: An empirical tale of distressed firms and assisting banks. *International Review of Law and Economics*, 429-454.
- Cuny, C. J., & Talmor, E. (2007). A theory of private equity turnarounds. *Journal of Corporate Finance*, 629-646.
- Department of Justice Canada. (1985a). *Companies' Creditors Arrangement Act (R.S.C., 1985, c. C-36)*. Retrieved April 5, 2012, from Department of Justice Canada: <http://laws-lois.justice.gc.ca/eng/acts/C-36/>
- Department of Justice Canada. (1985b). *Bankruptcy and Insolvency Act, RSC 1985, c B-3*. Retrieved April 22, 2012, from Canadian Legal Information Institute: <http://www.canlii.org/en/ca/laws/stat/rsc-1985-c-b-3/latest/>
- Gaur, V. (2012). Post-petition financing in corporate insolvency proceedings. *Issue I of Taxmann's SEBI & Corporate Laws Journal, Volume 111*, 17-26.
- Gilson, S. C. (1995). Investing in distressed situations: A market survey. *Financial Analysts Journal* 51, 8-27.
- Goldblatt, T. (2012). Alternate financing sources. *Journal of Corporate Renewal*, 4-9.
- Grace, S. A. (2012, January 28). *Proceedings under Canada's Companies' Creditors Arrangement Act*. Retrieved Aug 12, 2012, from American Bankruptcy Journal Institute: <http://journal.abi.org/content/proceedings-under-canada%E2%80%99s-companies%E2%80%99-creditors-arrangement-act>
- Guest, G., Bunce, A., & Johnson, L. (2006). How many interviews are enough? An experiment with data saturation and variability. *Field Methods* Vol 18 (1), 59-82.

- Guion, L. A. (2006). *Conducting an In-Depth Interview*. Retrieved April 18, 2012, from <http://edis.ifas.ufl.edu/FY393>
- Hedly, N. (2012, November 2). *1time files for liquidation*. Retrieved November 5, 2012, from Business Day Live: Business / Transport & Tourism: <http://www.bdlive.co.za/business/transport/2012/11/02/1time-files-for-liquidation>
- Investopedia. (2012b). *Dictionary: Private Equity*. Retrieved April 24, 2012, from Investopedia.com : <http://www.investopedia.com/terms/p/privateequity.asp#axzz1sxXp6Y83>
- Leedy, P. D., & Ormrod, J. E. (2001). *Practical research: planning and design. 7th edition*. Upper Saddle River: Merrill Prentice Hall.
- Levinthal, D. A. (1991). Random walks and organizational mortality. *Administrative Science Quarterly* 36(3), 397-420.
- Lin, B., Lee, Z.-H., & Gibbs, L. G. (2008). Operational restructuring: reviving an ailing business. *Management Decision* 46(4), 539-552.
- Marshall, C., & Rossman, G. B. (2006). *Designing Qualitative Research*. Thousands Oaks: Sage Publication.
- McMillan LLP. (2009, October). *Insolvency Proceedings in Canada*. Retrieved August 6, 2012, from McMillan Publications: [http://mcmillan.ca/files/ACLF\\_Insolvency\\_Proceedings\\_in\\_Canada\\_0911.pdf](http://mcmillan.ca/files/ACLF_Insolvency_Proceedings_in_Canada_0911.pdf)
- Odendaal, N. (2012, July 26). *Sanyati business rescue proceedings terminated* . Retrieved September 7, 2012, from Engineering News: <http://www.engineeringnews.co.za/article/sanyati-business-rescue-proceedings-terminated-2012-07-26>
- Pelser, H. (2012, September 4). *SA's business rescue track record*. Retrieved September 20, 2012, from Moneyweb: <http://www.moneyweb.co.za/mw/content/en/moneyweb-industrials?oid=609761&sn=2009+Detail>
- Pretorius, M. (2008). When Porter's generic strategies are not enough: complementary strategies for turnaround situations. *Journal of Business Strategy* 29(6), 19-28.
- Pretorius, M. (2009). Defining business decline, failure and turnaround: a content analysis. *SAJESBM NS*, 1-16.

- Pretorius, M. (2012, July 11). Business Rescue Plans (unpublished research).
- Republic of South Africa. (2008). *South African Companies Act 71 of 2008*. Retrieved February 22, 2012, from Government Gazette No 32121 Volume 421:  
<http://www.info.gov.za/view/DownloadFileAction?id=98894>
- Rogers, R. B. (2012, February 13). *An Overview of Bankruptcy and Insolvency Law in Canada*. Retrieved July 26, 2012, from HDAS Articles:  
<http://www.hdas.com/Articles/1234565342bankruptcy-insolvency.pdf>
- SAPA. (2012, May 11). *Provisional liquidation for Velvet Sky*. Retrieved September 3, 2012, from Fin24: <http://www.fin24.com/Companies/TravelAndLeisure/Provisional-liquidation-for-Velvet-Sky-20120511>
- Saunders, M., & Lewis, P. (2012). *Doing Research in Business & Management*. Harlow: Pearson Education Limited.
- South African Revenue Services, 15080/2012 (High Court of South Africa (Western Cape High Court, Cape Town) October 31, 2012).
- Statistics South Africa. (2012). *Statistical Release P0043 Statistics of liquidations and insolvencies (Preliminary)*. Retrieved November 5, 2012, from [www.statssa.gov.za](http://www.statssa.gov.za)
- The Insolvency Service. (2009, November). *Insolvency Service Consultation Documents Register Archive*. Retrieved August 25, 2012, from The Insolvency Service:  
[http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/con\\_doc\\_register/registerindex.htm](http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/con_doc_register/registerindex.htm)
- Timimi, K. (2010). *Sources of Finance*. Retrieved April 24, 2012, from Economy Watch:  
<http://www.economywatch.com/finance/sources-of-finance.html>
- Tsuruta, D., & Xu, P. (2007). Debt Structure of Financially Distressed Small Businesses. *RIETI Discussion Paper Series 07-E-032*.
- UK Statutes Crown. (1986). *Insolvency Act 1986*. Retrieved April 3, 2012, from National Archives UK:  
<http://webarchive.nationalarchives.gov.uk/+http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/uk/insolvencyact.pdf>
- UNCITRAL. (2005, August). *UNCITRAL Legislative Guide on Insolvency Law*. Retrieved September 7, 2012, from UNCITRAL Texts & Status: Insolvency:  
[http://www.uncitral.org/pdf/english/texts/insolven/05-80722\\_Ebook.pdf](http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf)

- United States of America. (2002). *Bankruptcy – Chapter 11, Reorganization*. Retrieved April 10, 2012, from US Bankruptcy Code Section 1104:  
<http://uscode.house.gov/download/pls/11C11.txt>
- van der Walt, J. (2006). Implications of new business rescue legislation for private equity in South Africa. *Private Equity World Africa 2006*, (pp. 1-26).
- Vriesendorp, R. D., & Gramatikov, M. A. (2010). Funding corporate rescue: The impact of the financial crisis. *INSOL International Insolvency Review*, 209-237.
- Wilson, K., & Deniz, A. (2008, October 7). *Publications: A Short Guide to UK Insolvency Law: Administration*. Retrieved July 4, 2012, from Paul Hastings:  
<http://www.paulhastings.com/publicationDetail.aspx?publicationId=1028>
- World Bank. (2005, December 21). *Insolvency and Creditor Rights*. Retrieved September 7, 2012, from The World Bank Group: Reports on the Observances of Standards and Codes: [http://www.worldbank.org/ifa/rosc\\_icr.html](http://www.worldbank.org/ifa/rosc_icr.html)
- World Bank. (2005). *Principles for Effective Insolvency and Creditor Rights Systems - Revised Draft*. Retrieved April 2012, 14, from <http://www.worldbank.org/ifa/IPG%20-%20Revised%20Pples%20FINAL%20%5B21%20Dec%202005%5D.pdf>
- Yin, R. K. (2003). *Case Study Research: Design and Methods*. Thousand Oaks: Sage Publications.

# APPENDIX 1 – LIQUIDATION STATISTICS

(Statistics South Africa, 2012)

Figure 1 – Number of liquidations

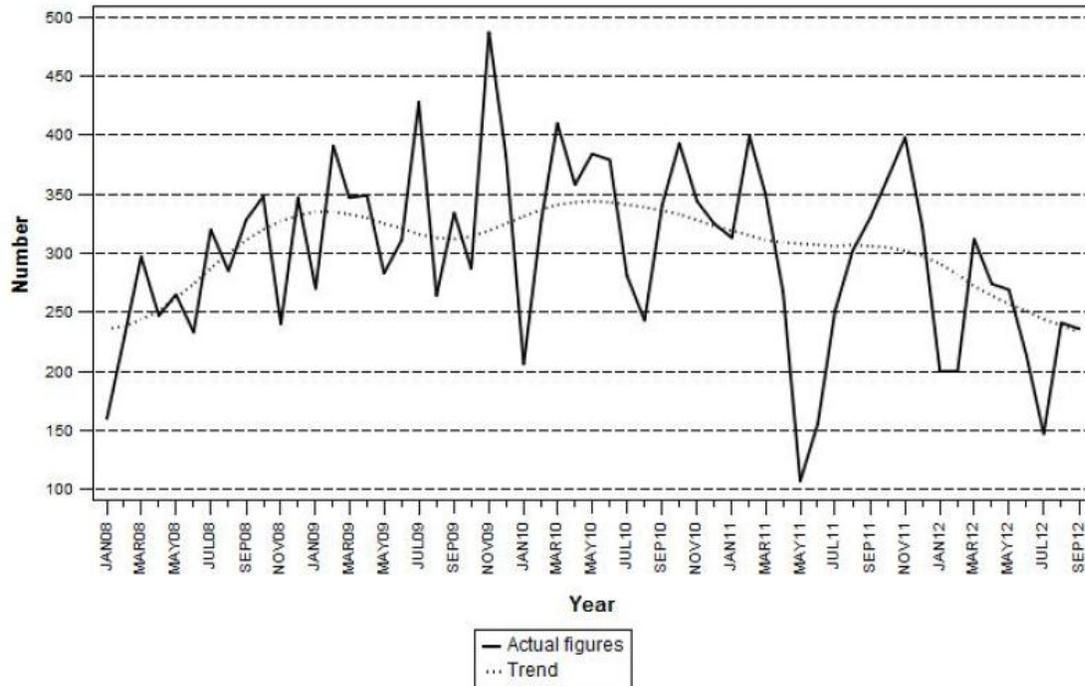
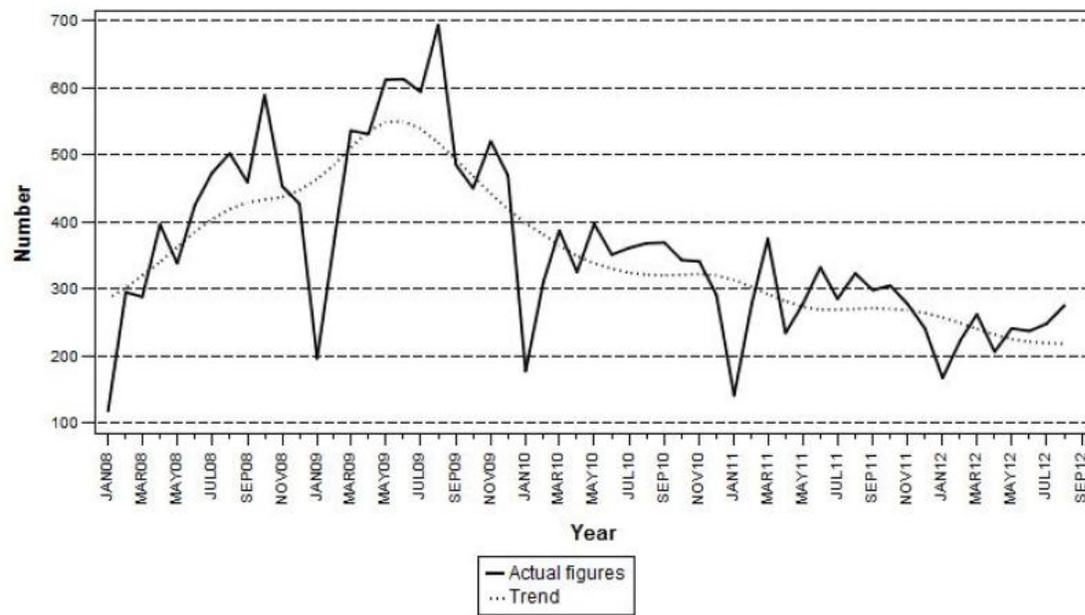


Figure 2 – Number of insolvencies



## APPENDIX 2 – SECTION 135 OF CHAPTER 6 OF THE COMPANIES ACT 71 OF 2008

(Republic of South Africa, 2008)

### Section 135: Post-commencement finance

as amended by section 86 of the Companies Amendment Act No. 3 of 2011

(1) To the extent that any remuneration, reimbursement for expenses or other amount of money relating to employment becomes due and payable by a company to an employee during the company's **business rescue proceedings**, but is not paid to the employee—

(a) the money is regarded to be post-commencement financing; and

(b) will be paid in the order of preference set out in **subsection (3)(a)**.

(2) During its **business rescue proceedings**, the company may obtain financing other than as contemplated is **subsection (1)**, and any such financing—

(a) may be secured to the lender by utilising any asset of the company to the extent that it is not otherwise encumbered; and

(b) will be paid in the order of preference set out in **subsection (3)(b)**.

(3) After payment of the **practitioner's** remuneration and expenses referred to in **section 143**, and other claims arising out of the costs of the **business rescue proceedings**, all claims contemplated—

(a) in **subsection (1)** will be treated equally, but will have preference over—

(i) all claims contemplated in **subsection (2)**, irrespective of whether or not they are secured; and

(ii) all unsecured claims against the company; or

(b) in **subsection (2)** will have preference in the order in which they were incurred over all unsecured claims against the company.

(4) If **business rescue proceedings** are superseded by a liquidation order, the preference conferred in terms of this section will remain in force, except to the extent of any claims arising out of the costs of liquidation.

## APPENDIX 3 – LIST OF INTERVIEWEES

<b>Name of respondent</b>	<b>Company Name</b>	<b>Role / Responsibility</b>	<b>Nature of Expert Role</b>
<b>Tony Flynn</b>	TMP SA	Owner	Business rescue practitioner
<b>Karl Gribnitz</b>	Gandalf Trust	Owner	Business rescue practitioner
<b>Gert Holtzhauzen</b>	Strategic Turnaround Solution	Owner	Business rescue practitioner
<b>Harry Kaplan</b>	First City Administrators	Trustee	Business rescue practitioner
<b>Hans Klopper</b>	Independent Advisory	Managing Director	Business rescue practitioner
<b>Leslie Matuson</b>	Matuson & Associates (Pty) Ltd	Shareholder	Business rescue practitioner
<b>Trevor Murgatroyd</b>	TM Restructuring	Director	Business rescue practitioner
<b>Stefan Steyn</b>	Business rescue Partner	Owner	Business rescue practitioner
<b>Deon van Rooyen</b>	Marcape	Owner	Business rescue practitioner
<b>Eric Levenstein</b>	Werksmans	Partner	Attorney specialising in Business rescue, Restructuring and

			Insolvency Law
<b>Loris Cappilati</b>	Standard Bank	Business Support & Rescue Recoveries	Financier
<b>Shaun Collyer</b>	Batian Fund	Private Equity Specialist	Financier
<b>Haroon Docrat</b>	Industrial Development Corporation	Workout and restructuring Team	Financier
<b>Jethro Goredema</b>	Development Bank South Africa	Turnaround Specialist – Business Support & Recovery Unit	Financier
<b>Amy Luus</b>	Standard Bank	VAF Personal Credit	Financier
<b>Bruce MacRobert</b>	Brait South Africa	Director (Equity Investor)	Financier
<b>Herbie Nicholson</b>	ABSA Bank	Team Leader: Credit Restructuring & Advisory Group	Financier
<b>Coenraad van Beek</b>	Nedbank	Strategic Business Renewal	Financier

## APPENDIX 4 – INTERVIEW GUIDE

<u>Type of study:</u>	Exploratory and explanatory (semi-structured)
<u>Instrument:</u>	Note Pad, Audio recorder
<u>Interview guide format:</u>	Flexible depending on the course of the conversation, follow-up and new questions raised.

### PREPARATION BEFORE THE INTERVIEW

Before the interview, the interviewer should prepare or plan for the following:

- Be punctual, courteous and explain the administrative requirements i.e. recording of the interviews.
- A suitable location should be used - choose a setting with least distractions.
- Start the conversation by discussing the elements of mutual interest and building rapport e.g. state of the economy, industry and competitiveness of industry.
- Reading about the expert's background information, company activities and topical issues in the industry.
- Preparing for "warm up" questions to foster a relaxed and cordial atmosphere.

### WARM UP AND BACKGROUND

- Ensure you spend some time building rapport initially.
- Ask good questions and interpret the answers.
- Be a "good listener" and avoid being trapped by own ideologies or preconceptions.
- Be adaptive and flexible.
- Be aware of body language.
- Have firm grasp of the issues being studied.
- Remain neutral - be unbiased by preconceived notions, including those derived from theory.
- Ask what the person would do in an actual situation, rather than in a hypothetical one.
- Do not put words in their mouth.
- Responses should be recorded verbatim.

- Don't react to what the person tells you.
- Always treat their responses as perceptions, not fact.
- Ensure that you test your own understanding and to sharpen the focus of vague comments.

## 1. Introduction

*Hello my name is Wanya du Preez and I am conducting this interview in partial fulfilment of my Masters of Business Administration degree at the Gordon Institute of Business Science.*

### 1.1 Purpose of interview: discuss the purpose of the interview -

Learning the respondent's viewpoint regarding situations relevant to the broader research problem: The purpose of the interview is to solicit expert opinions from senior BRPs and experts in financial institutions in an effort to obtain an understanding of the current nature and extent of PCF in Business rescue in SA.

*The purpose of this interview I am seeking to ascertain what **the status (i.e. nature and extent) of post-commencement finance in business rescue in South Africa is.***

*You have been **asked to participate** in this interview because of your role as a Business rescue practitioner / Financial Institution Expert in \_\_\_\_\_ organisation and you are therefore considered an expert within this field.*

### 1.2 Interview administration

- Explain the format of the interview.
- Indicate how long the interview usually takes.
- Provide contact information of the interviewer.
- 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.
- Allow interviewee to clarify any doubts about the interview.
- Prepare a method for recording data, e.g., take notes and setting up recorder.
- Discuss and agree on terms of what will be done with data from the interview.
- Explain process of data collection and analysis.

*This interview should take **approximately 60 - 90 minutes**. Please answer the questions to the best of your ability.*

*As you read in the informed consent form, your responses will be kept confidential and you will never be identified by name or role when we report the results of these interviews, your responses will also be recorded. You are free to stop participating or withdraw at any time. Let me know if you would like to skip a question for any reason.*

*Are you comfortable with the fact that I am recording the interview?*

*May I start the interview now?*

**[Start Recording]**

## 2. Interview Guide

**[During the interview:**

- **Record observations of a non-verbal nature to supplement and contextualise the recordings on the audiotape.**
- **The format of the interview is semi-structured with some pre-planned questions below, while allowing for a natural free flow of conversation and questions.**
- **Seek understanding and interpretation of what was heard.**
- **Search for a deeper understanding and clarity from the respondent throughout the interview.**
- **Encourage responses.]**

NOTE: Interviews began with an invitation to ‘tell the story’ of the business rescue proceedings.

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

Research Question	Other Exploratory Questions	Probing Question	Interpreting Question
<b>RQ #1:</b> What are the key prescriptives internationally around post-commencement finance?	<p><u>Expert's perspectives, thinking, experiences and decision-making:</u></p> <p>The major countries that the South African legislation is based on are: USA, UK, Canada, and Australia.</p> <ul style="list-style-type: none"> <li>• Are you familiar with the international legislation around business rescue and post-commencement finance? If yes:</li> <li>• What are the key similarities and differences between their and SA legislation?</li> <li>• What practices exist around financing businesses in rescue in these countries?</li> <li>• What categories could be used to analyse the key differences between the legislation in these countries e.g. DIP control; PCF; Philosophy etc.</li> <li>• What is the difference between the 'rescue culture' internationally vs in SA?</li> <li>• Is the ranking (i.e. priority stats) of deb the same locally as internationally?</li> </ul>	<p>What other thoughts do you have on the matter?</p> <p><u>Context:</u> Do you have an example of a real life case study that illustrates this?</p>	Is it correct that...?
<b>RQ #2:</b> In your experience, what is the current nature	<p><u>Expert's perspectives, thinking, experiences and decision-making:</u></p>	Why do you think/say this?	So what you are saying is....?

<p>and extent of post-commencement finance for Business rescue in South Africa?</p>	<ul style="list-style-type: none"> <li>• Could you describe what you believe the nature of PCF is in SA currently, i.e. what does the landscape look like and what are the different options available?</li> <li>• Could you describe what you believe the extent of PCF is in SA currently, i.e. what is the magnitude or scope of financing currently available as well as advanced/issued?</li> <li>• If there is little/no PCF, why do you think that is?</li> <li>• Where it is being advanced, who is the typical role player providing the finance, and in what form?</li> <li>• When do banks / shareholders / trade creditors / management provide finance?</li> <li>• What is the role of development finance institutions in this regard? i.e. IDC / DBSA etc</li> <li>• What opportunities are there for Private Equity firms / Distressed Debt Financiers? Why is it not happening more as in the USA?</li> </ul>	<p>Why do you think this is the case?</p> <p><u>Context:</u> Do you have an example of a real life case study that illustrates this?</p>	
<p><b>RQ #3:</b> What are the different phases of post-commencement finance that a business in distress</p>	<p><u>Expert's perspectives, thinking, experiences and decision-making:</u></p> <ul style="list-style-type: none"> <li>• Where does cash flow financing for daily operations fit in?</li> <li>• Where does new financing to turn the organisation around fit in ('restructuring financing')?</li> </ul>	<p>Could you please explain that a little more for me?</p> <p><u>Context:</u> Do you have an example of a real life case</p>	<p>To clarify you mean that...?</p>

needs?	<ul style="list-style-type: none"> <li>• What source and type/form of financing do both of these take place in?</li> </ul>	study that illustrates this?	
<p><b>RQ #4:</b> Are there known prerequisites for successful post-commencement finance that you have obtained through your experience?</p>	<p><u>Expert's perspectives, thinking, experiences and decision-making:</u></p> <ul style="list-style-type: none"> <li>• Which success factors are important to ensure that PCF is raised?</li> <li>• Which success factors relate to the company in distress (e.g. age, size, ownership)?</li> <li>• Which success factors relate to the nature and extent of the financing?</li> <li>• Which success factors relate to the timing of the financing?</li> <li>• Which success factors relate to other aspects?</li> <li>• What is the role of the Business rescue practitioner in this i.e. the ability to raise PCF?</li> </ul>	<p>Please can you elaborate a little more on your thoughts about this?</p> <p><u>Context:</u> Do you have an example of a real life case study that illustrates this?</p>	<p>To make sure I understand you correctly, you believe that....?</p>
<p><b>RQ #5:</b> What would you describe as the reasons for lenders' (banks, private equity firms, other institutions etc.) disinterest in post-commencement</p>	<p><u>Expert's perspectives, thinking, experiences and decision-making:</u></p> <ul style="list-style-type: none"> <li>• Who are the main lenders who typically provide financing for businesses in distress?</li> <li>• Who are the main lenders who don't typically provide financing for businesses in distress?</li> <li>• What are the main reasons for each of the above?</li> </ul>	<p>Could you perhaps give me a bit more detail/ examples about your response?</p> <p><u>Context:</u> Do you have an example of a real life case</p>	<p><b>Would it be accurate to quote you by saying that....?</b></p>

<p>finance?</p>	<ul style="list-style-type: none"> <li>• Do these reasons differ between the types of lenders?</li> <li>• What are the key attributes / criteria / indicators that lenders consider when advancing finance to distressed businesses?</li> <li>• Where do you believe the potential untapped opportunities are in this area?</li> </ul>	<p>study that illustrates this?</p>	
<p><b>RQ #6:</b> What are the stages (or situations) of decline/financial distress and how do they impact/determine the success of the business rescue proceedings?</p>	<p><u>Expert's perspectives, thinking, experiences and decision-making:</u></p> <ul style="list-style-type: none"> <li>• What do you believe the key stages / situations are that companies that are in financial distress find themselves in?</li> <li>• How does each of these stages impact the level and likelihood of raising and receiving financing for the business rescue process?</li> <li>• Which stage has the highest probability / historical results of ending in a successful business rescue effort?</li> <li>• When is the best time to provide PCF which will achieve a higher success rate in turning the business around?</li> </ul>	<p>Please expand a bit more on this aspect?</p> <p><u>Context:</u> Do you have an example of a real life case study that illustrates this?</p>	<p>What I heard you saying is...?</p> <p>(Saunders and Lewis, 2012)</p>

**[Continually verify that the recorder is still working]**

**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?
- c) In your opinion did I leave out any important topics?
- d) Do you have any additional questions for me?
- e) What is the future of PCF for SA?

**[Stop Recording]**

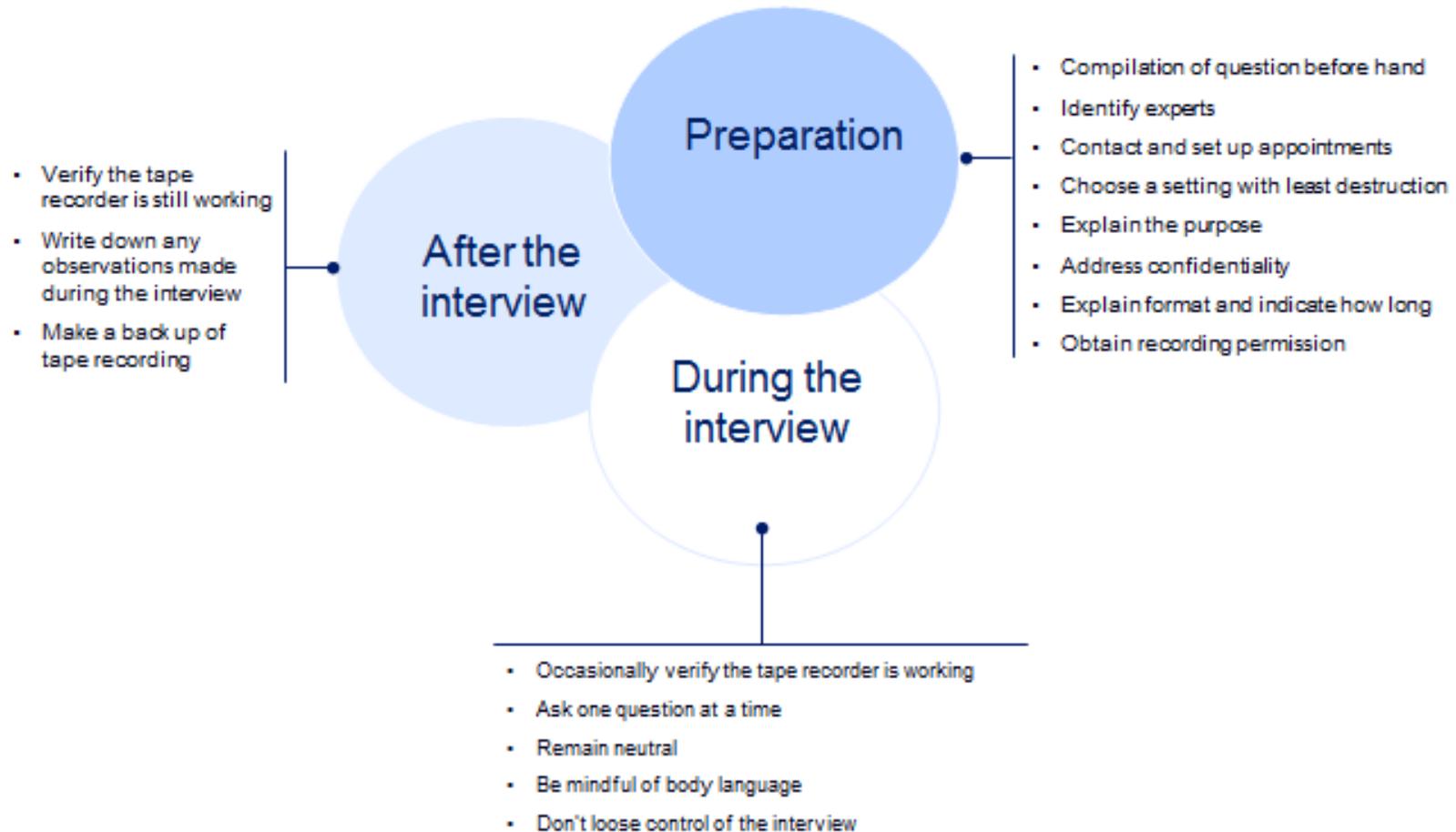
**4. Post-interview procedure**

- a) Verify if the tape recorder, if used, worked throughout the interview.
- b) Write down any observations and reflections made during the interview (include views and feelings immediately after the interview).
- c) Send e-mail to thank respondent for their time.
- d) Establish permission to contact the respondent for clarification and further information sharing should this be required.
- e) Make contact with individual the respondent has referred you to (as per 3b).

**5. Post-interview notes**

- a) Make a backup of the recording.
- b) Detail emerging themes from interview.
- c) Review 'depth' of interview from a data collection perspective.

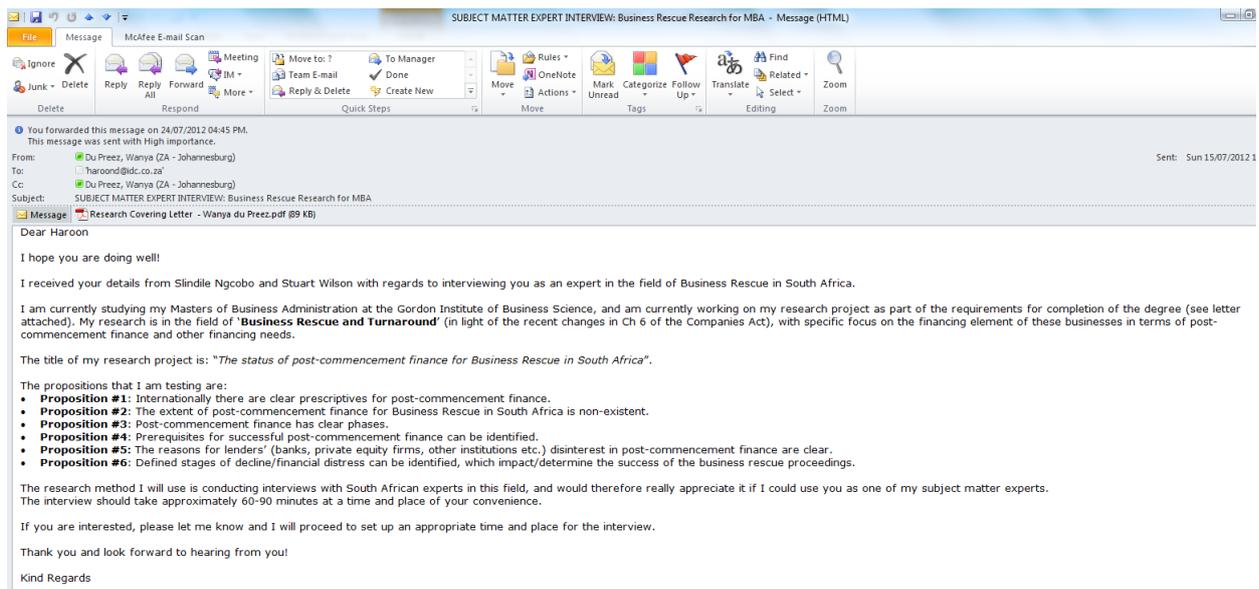
Interview logistics mind map:



## APPENDIX 5 – PRE-INTERVIEW PACK

The researcher would then send a pre-interview information pack, consisting of:

- A formal and personalised letter of introduction, which would include an undertaking of confidentiality, a written confirmation of the appointment and an undertaking to provide the respondent with a copy of the integrated research project report.



- A pre-interview guideline listing the questions that the researcher would ultimately like to have answered by the time the interview had been concluded (or as near as possible) was provided upon request. The guideline was not intended to be used in a mechanistic question and answer session, but was rather intended to be a tool that would enable the respondent to think about some of the issues that were destined for discussion during the in-depth “conversation”.
- An independent letter from the Gordon Institute of Business Science, confirming that the research and the researcher are legitimate.



18 June 2012

**TO WHOM IT MAY CONCERN**

This letter confirms that Ms Wanya du Preez (student number: 11357012) is currently completing her Masters in Business Administration (MBA) at the Gordon Institute of Business Science, University of Pretoria.

She is carrying out an Integrative Research Project as one of the components of the MBA and any assistance you could give her with collecting her data would be greatly appreciated.

Should you have any queries please do not hesitate to contact me.

Kind Regards,



**Adele Bekker**  
Senior MBA Manager  
GIBS  
[bekkera@gibs.co.za](mailto:bekkera@gibs.co.za)



## APPENDIX 6 – LETTER OF CONSENT



### Informed Consent Letter

I am conducting research towards my Masters of Business Administration ('MBA') at the Gordon Institute of Business Science ('GIBS') on the status of post-commencement finance for Business rescue in South Africa. All participants will be asked to share their insights and experience on the topic, in light of their expert opinion. All data collected via the interview process and any documents received from you will be treated in the strictest of confidence and all reporting of any findings will be done without identifiers. To this end, you are kindly requested to provide sincere and detailed responses in the interview to enhance the quality of the data. This will help us better understand the dynamics at play in the context of post-commencement finance in Business rescue in South Africa and therefore add to the theory base as well as the understanding of the practice in this relatively new industry. Our interview is expected to last approximately an hour to an hour and a half, and will enrich business practitioners, scholars and any interested party to understand the nature and extent of post-commencement financing in South Africa, as well as the prerequisites for success. Your participation is voluntary and you can withdraw at any time without penalty. Of course, all data will be kept confidential. If you have any concerns, please contact me or my supervisor. Our details are provided below.

**Researcher name:**

Name : Wanya du Preez

Email : [wanyalabuschagne@gmail.com](mailto:wanyalabuschagne@gmail.com)

Phone : 011 209 6126

Mobile : 083 272 0892

**Supervisor name:**

Name : Prof Marius Pretorius

Email : [marius.pretorius@up.ac.za](mailto:marius.pretorius@up.ac.za)

Phone : 012 420 3394

Mobile : 082 822 6333

Signature \_\_\_\_\_ Date \_\_\_\_\_

**Interviewee/Participant Details**

Name :

Email :

Phone :

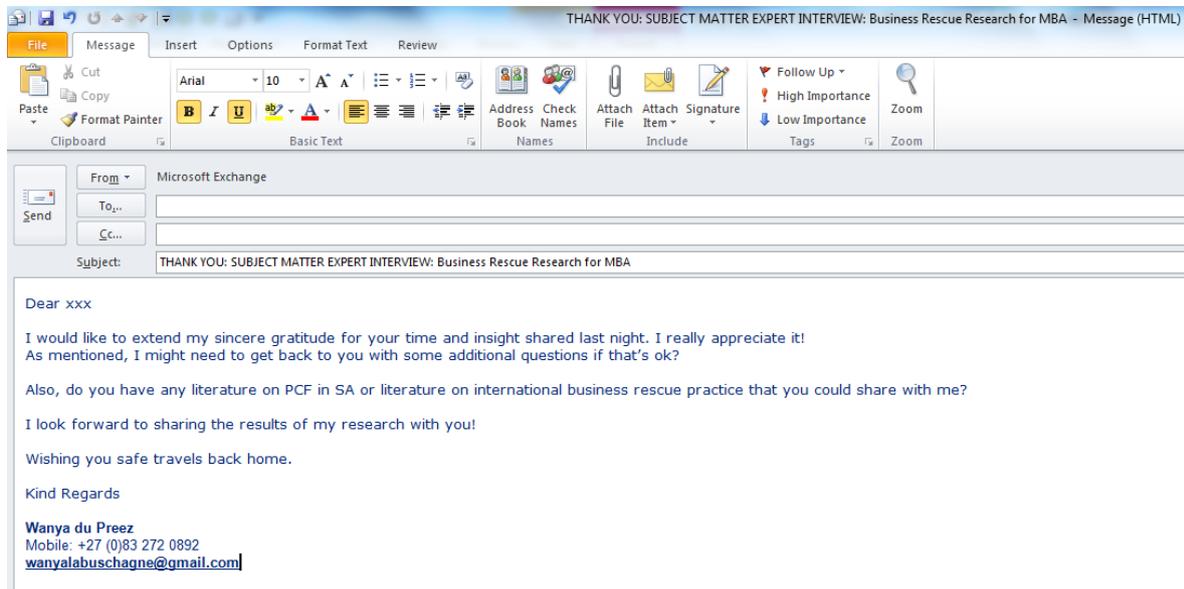
Signature \_\_\_\_\_ Date \_\_\_\_\_

-----

**Note: Discussion Guide**

A discussion guide is intended as an outline only. There will be considerable scope within the discussion for exploring issues as they arise.

## APPENDIX 7 – POST-INTERVIEW THANK YOU NOTE



# APPENDIX 8 – DETAILED RESULTS: RESEARCH PROPOSITION ONE

## Australia

### The role of the Administrator

BRP5: “In Australia they appoint an administrator and there he can decide to liquidate, and he becomes the liquidator, the same guy. Here the practitioner cannot be the liquidator.”

FIN2: “There is no differentiation between the two. So the business rescue practitioner as long as he is a liquidator can become the liquidator of the estate if it moves from business rescue to provisional liquidation or final liquidation.”

### The approach to Business rescue

BRP2: “Basically what would happen is you the company would approach an administrator or call it business rescue and the guy would do feasibility beforehand of the prospects of success. He would engage major role players; he would then give a proposal of what he sees and how to do it because in effect the rescue there you basically become fully responsible from day one for everything. So it is a hell of a responsibility to take on an administration in Australia. So the guys are quite fussy of making sure that all the role players know where we stand. “

FIN4: “Now for example there it is very much more formalized but much more effective in terms of their court system. So for example once you have prepared a plan you don’t present it to the creditors you have to go back to court and present the plan; obviously you need to get the creditors approval but it is quite a strictly driven court process. So they have insolvency courts with specialized judges that drive that process, and it is very strictly controlled in terms of the timeframes.”

### Post Commencement Finance

BRP4: “It is easier for those guys then to as post commencement restructure the current loan, put it into a new post commencement bracket, secure it and then continue.”

## Canada

### The role of the Monitor

“They call it a monitor and that is almost like an official and he monitors the process. There is no real practitioner involved, so we are unique from that point of view.”

BRP1: “Chapter six was writing by a Canadian so a lot of the UK stuff [is] in chapter six, given where they are next to the US, has obviously brought this post commencement finance in defining the act.”

BRP3: “So I think when they starting drafting our new bill and looking at Chapter 6, and as you know it was written by the Canadians, I think we obviously imported the thinking behind compromising debt within a restructuring position like what is often in business rescue, as well as this whole thing about post commencement finance.”

## United Kingdom

### The role of the Administrator

FIN2: “there is no differentiation between the two. So the business rescue practitioner as long as he is a liquidator can become the liquidator of the estate if it moves from business rescue to provisional liquidation or final liquidation.”

### Post Commencement Finance

BRP4: “If you look at the English model your secured creditors don’t even have a voting right because they are secured.”

BRP1: “The banks didn’t like it so it never got through basically, but they called for responses ...British Banking Association is very very strong so unless they really like some proposals they can subtly use a lot of pressure.”

## United States of America

### The role of the Turnaround CEO

BRP5: “The practitioner is a businessman in a way in that you are a co-director, well you are above the directors, you have got a position of fiduciary responsibility.”

FIN3: “But one of the things that is inherent in the US bankruptcy code, the whole point of it is that management have some protections in the sense that what their fiduciary obligation is to keep the business going, that is where the fiduciary obligation lies; now yes they do have a fiduciary obligation to the creditors to maximize their value but that is a regimented process in the court and the directors are absolved.”

FIN3: "One of the observations obviously in the US in the Chapter 11 process the lawyers along with the other practitioners that are involved, whether they be consultants or valuation agents, their scope and powers are extremely limited and the entire process is extremely public."

### The approach to Business rescue

FIN3: "Whereas in the US I had far more confidence because of a lot of case precedents, so I knew it was a fairly prescriptive process, knew what the outcome was going to be, it was productive and the process was predictable. Then the bet became am I betting on the right person, with the right management team and the right business. That was the skill then that differentiates you; whereas here there are too many variables."

FIN3: "So step one is prescribed to define markets it is mature, it is tried and tested, people know how it works, there are a number of players in the market who understand the process and have done it many times. So I think the US is very mature."

BRP3: "In America it is about the interests of the debtor, the debtor company, the company that is in the process owes money to creditors."

FIN2: "Chapter 11 was intended to protect businesses in distress like we have that as an intention. The difference is that they have a support structure in place already to provide that support from a legal perspective."

FIN3: "Provide protection to its employees and directors, not to the shareholders, the shareholders do lose and that is the premise of them and that is why equity is the risk capital, but to provide protection to the employees and the managers of the business to take the business through an orderly process of dealing with their debts - that is where Chapter 6 misses the point."

FIN3: "That is the whole premise behind the formalized process [is] to preserve creditors to maximize their value by giving the company a set of tools to work its way through. So long term, is that the senior debt recovery rate under Chapter 11 in a well-run process was 80c or 90c on the dollar. A lot of those assets went into bankruptcy were 30c or 40c on the dollar but because the process created value and preserved value sustained the business and the recovery rate was much higher."

BRP2: "If you go to Chapter 11 if you take American Airlines, it is finance, the deal is done before Chapter 11; they didn't wake up and say let's do Chapter 11."

FIN3: "So to start with the US has a fairly robust systematic organized post commencement financing environment, but there are private equity funds whose sole business is post commencement financing. In the US it is called DIP financing."

FIN3: "So the first thing to compare is that there it is formalized, it is recognized, people understand and know the terms and conditions that are associated with DIP financing to the point where DIP financing terms are becoming quite standardized. You can't go to bankruptcy court with a non-conforming set of terms and conditions as a DIP financier. It is fairly prescriptive, and what you do is literally take the other guy's name out, put your name in, take out the fees and the interest rates and negotiate around that, but everything else is fairly standardized and formalized. In fact I think in the legislation there are prescriptive methods and there is enough present case law that tells you exactly how it is going to work, so when a company approaches Chapter 11 and they begin to consider filing they know exactly what they are going to get for DIP financing; whereas in South Africa nobody knows."

FIN3: "They knew the rules of the game; the company would file Chapter 11 on a Sunday night by Monday evening [they] had DIP financing lined up in place ... because they knew what the rules of the game were."

FIN4: "Those entities have been set up because they are highly profitable just by the way too, because they charge very high premium for funding, so they are taking almost an equity risk."

BRP6: "In fact the rates that they charge in the US on the pre-packs is cheaper than anything else on the normal rates because they understand it and the technology is so good, they understand that they are first most senior debt level so it is quite good lending."

FIN3: "DIP financing is ... first money out. So it is the last capital in first capital out including all of its fees and expenses, that is all protected ... people know when they provide DIP financing, when the business exits some restructuring process they are the first capital to get repaid and their fees and expenses are protected by legislation. If you look at the bankruptcy code in the USA there is administrative claim one through administrative claim eight, so administrative claim one is always taxes and employees benefits and administrative claim two is post commencement financing."

FIN3: "In the US bankruptcy code... Administrative Claims and under that is all post financing claims, then after that comes all employee claims including all the pension claims and the third one is all tax claims. So that comes third and then it comes to secured debt and it goes down in the trickle schedule. So that is business preservation, the government wants to make sure their tax is fine, that is the most important thing. And that's blatantly obvious in Chapter 6, there is no provision there for paying taxes."

### Rescue culture and mindset

BRP4: "Yes it is the total opposite; you must remember in the United States if you are liquidated or sequestrated you can start the next day."

FIN3: "Whereas in the US I mean it is fairly common, companies are not afraid to file for Chapter 11, they are not afraid, it is not 20 years ago...there was still a little bit of stigma attached to filing for bankruptcy. By the mid-2000s post the internet bubble, you know what it is normal, every three to five years businesses file for Chapter 11. The CEO who ran it he comes out unscathed on the other side, does something different or he in many cases continues to run the business."

# APPENDIX 9 – DETAILED RESULTS: RESEARCH PROPOSITION TWO

## Extent of PCF in South Africa

FIN1: “We haven’t granted an overdraft or a medium term loan or anything like that; we haven’t really been requested to.”

FIN5: “I won’t say it is not happening but I think in the majority of cases it is not happening because of the exact reasons we just discussed...you get to the point where they file for business rescue, there is either nothing or very little as it stands, that is not encumbered already.”

FIN6: “I think that is the normal rule of thumb that you don’t want to put in money because you are already losing money.”

FIN7: “In every single case so far we have never accorded any post commencement finance... Well we weren’t asked to.”

BRP7: “It is very simple, the answer to that is it is being advanced; it is being advanced where the funders feel comfortable that the practitioner has actually got a plan that has got a reasonable prospect of success.”

BRP2: “The reason business rescue didn’t work was because there was no post commencement finance.”

BRP3: “Post commencement finance is a critical leg to business rescue...it is probably the most fundamental leg to the process, without it, it is stillborn.”

BRP4: “Business rescues are unsuccessful due to the fact that we don’t get post commencement funding from the traditional funders... you can have an up skilled fully totally equipped business rescue practitioner who is going to fail because he can’t get his hand on post commencement funding.”

BRP7: “Post commencement funding is the secret to success of business rescue. Without post commencement funding you don’t have business rescue, you’ve got nothing...it’s like the oxygen tank for the patient. Without the oxygen he is going down.”

BRP10: “As soon as you have got somebody with a cheque, the chances of successful business rescue just rocket.”

FIN1: “Ultimately successful post commencement finance is successful business rescue.”

FIN5: “I want to say it is really the minority that gets through business rescue exactly because of this funding thing.”

FIN7: “Yes...but if the bank doesn’t come in and actually put some money on the table then it is pretty much a non-starter.”

## Responses from BRPs

BRP4: “They also try to still dictate the business rescue as well. They have got all these demands and it is not really applicable to the business rescue, but because they are the biggest secured creditor they have got the biggest vote so they can manipulate the plan by voting against it or voting for it. So they will use that muscle to then dictate the way, that is unfortunately what happens... they are just going to withdraw their support and they are one of the bigger creditors so you need to retain their support.”

BRP4: “Business rescues are unsuccessful due to the fact that we don’t get post commencement funding from the traditional funders”, they walk away from it and they see it as a breach. What happens with most of the contracts, and if you want to look at some of the contracts on credit supply contracts and all of those kinds of things, one of the breaches with judicial management, when you file for judicial management you are in breach of the contract. So a lot of them just replace the word judicial management with business rescue, so the breach clause stays there so if you file for business rescue you are in breach although it is contra bonis moris in terms of the Act you can’t do it, they have put it in there. So the mindset is still that if you file for business rescue you are in breach. So why do we need to fund somebody that is already in breach of our initial contract. So the market wasn’t ready for Chapter 6, they didn’t understand the implications or whatever the case may be.

BRP6: “What the banks are doing now is they take a lot of extra security that they actually don’t need, that’s the first issue. The second thing that they have now made directors do, is when you have a loan with them they force you to sign a document that says before you consider putting the business into business rescue, you have to consult the bank first ... Now that is illegal, it is contra to the Act; because how can I consult one creditor to do these things...You say to the bank I can’t sign this and the bank says to you well then I’m not going to give you a loan, and then.”

BRP5: “I had an investor in there; this person was prepared to provide post commencement finance and what goes with it, but the bank had suretyships over the two directors ...So we couldn’t come to a deal with the bank where they would take any form of write off - all the creditors agreed to take 15c in a Rand, the bank wouldn’t do it and we are today still struggling and we lost our post commencement financier because he was seeing that his finance would come in to finance the business so that the business sustains the bank debt and pay it off over years, and it would be too long for him to have a return.”

BRP2: “I think business rescue for South Africa is going to be a learning curve over the next ten to fifteen years.”

BRP5: “They want to see somebody else burn their fingers first and understand how they deal with it on that basis.”

BRP7: “I’m sure, as we do become more sophisticated, as people begin to understand the Act a whole lot better, and as the quality of the companies that are going into business rescue improves I’m sure you will find that sort of situation.”

BRP10: “Then there is a lot of case law showing that people start the business rescue process purely to delay what is perceived to be the inevitable and maybe in the hope that something is going to come off.”

BRP2: "We are dealing with the rubbish and everything, we have got a big circus here."

BRP8: "But business rescue is really there for stable companies. To me I don't think you should file for business rescue if the company is a year old."

BRP2: "So I seriously think that lawyers are misguiding in their approach to things with some of their clients and giving them bad advice; they tell them if you go into business rescue you are the master of your own destiny which I don't understand."

BRP3: "A lot of the companies that have filed for business rescue have been badly advised, they are abusing the process in a sense that they are all very excited about the moratorium on claims but they don't think about well is this a sustainable case for business rescue as opposed to liquidation. Generally, after resolution goes through those companies end up in liquidation."

BRP1: so if you are wanting to loan this money from any business so it is a successful business and it starts up, and you approach a funder and they want to see projections and cash flow forecasts; if you are going to ask somebody for financing in a business rescue they want to see the same things...I would also expect sensitivity analysis on the forecast, I don't know if people do it here. Whatever your key sensitivities are in the business, people tend to overestimate when they forecast...never put a plan together that won't protect whoever is putting the money in."

BRP4: "Yes; you know there is an initial period, if you get to publishing the plan, yes maybe then it is crucial to say to the guys listen here is my feasibility study, here is the plan or whatever, I need you to fund this."

BRP7: "Where a creditor believes that the plan is not necessarily the best result and if the plan is not approved then there is either an alternative plan or alternatively the company goes into liquidation. So if creditors don't vote for the plan then there is an alternative plan, then the practitioner puts the company into liquidation."

BRP7: "It is very simple, the answer to that is it is being advanced; it is being advanced where the funders feel comfortable that the practitioner has actually got a plan that has got a reasonable prospect of success. You are not going to find a funder who is already deep down a hole throwing more money down that hole unless they are confident that they are going to get their money back."

BRP1: "Some of the questions are very technical and I think you need case law to clarify them...But at the moment everyone is overwhelmed with the sort of legal and compliance issues and it is really a commercial, to make it work it is a commercial issue, so it needs I don't know a few more hand-ins and a few successes."

BRP3: "Our common law, which is case law and judgments, will eventually develop all of this into a flowchart of what is good and what is bad. Already we have seen very detailed judgments on how you should serve on affected persons, the post successful applications which gives us guidelines as to how to deal with it."

BRP4: "You see the problem with case law at this stage, I am not prepared as a business rescue practitioner to go and test certain issues on the Act by going to court, who is going to pick up the tab, not me, not to rewrite the law. If it happens in the normal course of business while you are busy doing a rescue, yes so be it."

BRP7: "That's what we need is precedent. We will get it, we will get it...As we get more and more precedents people will feel more and more comfortable I guess to actually put a bit of money into business rescue...I haven't seen anything about post commencement funding."

BRP8: "To me I think the thing is ours is so new and fresh, we haven't had court cases yet."

#### **Responses from Financiers**

FIN1: "There there are so many questions and loopholes and a whole lot still needs to be tested in court. So until we have those answers I think it might take a little bit of time if it ever gets off the ground."

FIN6: "Remember the legislation is still very new, in terms of the number of projects that have actually gone into business rescue and successfully been turned around, there are not many examples...there are no cases to look at to say according to this or that this is what we can actually do."

FIN3: "So to answer your question what is the state of post commencement financing in South Africa, there isn't because there is not sufficient legislated or precedent post commencement financing cases."

FIN5: "I won't say it is not happening but I think in the majority of cases it is not happening because of the exact reasons we just discussed...you get to the point where they file for business rescue, there is either nothing or very little as it stands, that is not encumbered already...because you seldom find that there is fixed property or anything else that is not encumbered".

FIN2: "At this stage in South Africa, and the only way we are learning is through case law, the fact that if somebody is put into business rescue one can still debate the merits before a judge and a business rescue application can be set aside....We can't put in millions for us to be a precedence setting case, and I think most of the financiers feel the same way."

FIN3: "In fact I think in the legislation there are prescriptive methods and there is enough present case law that tells you exactly how it is going to work, so when a company approaches Chapter 11 and they begin to consider filing they know exactly what they are going to get for DIP financing; whereas in South Africa nobody knows...So there is a disconnect and there is no case precedent...So to answer your question what is the state of post commencement financing in South Africa, there isn't because there is not sufficient legislated or precedent post commencement financing cases... In South Africa I don't have enough cases to be able to tell you on which of the three blinked first...I don't think there has been enough just instinctively enough precedence for the judges, the practitioners, the presenting council to really kind of know, they are kind of feeling their way through it I think is my view on it."

FIN4: "I think the difficulty always with creditors is that there is always a cost benefit for us, we need to assess whether in every instance we challenge them, in other words go to court and incur the expenses - it is a very expensive process to go to court so to challenge every single or every business rescue where we suspect that it may not be upfront and honest is just not cost effective. You see there is now a tradeoff before us, obviously those that are blatantly... we don't trust the individuals, they are fraudsters or the like, we then go for the jugular - we are prepared to throw money at it to achieve a liquidation or similar."

FIN6: "No one wants to be the test case, so you don't want people to be talking about business rescue by saying this bank look how they have been [banked] by this, everyone is a bit cautious to say let's see what happens with this. It is more of a wait and see attitude, and because of that as I was saying a lot of the projects are probably not big projects that are going into business rescue; they are slightly on the small side, where a bank is probably saying look we have already lost on this project let's see how it works in business rescue. It will help us to learn the ropes about business rescue; so that is exactly what it has been lately...Remember the legislation is still very new, in terms of the number of projects that have actually gone into business rescue and successfully been turned around, there are not many examples...there are no cases to look at to say according to this or that this is what we can actually do. So because of that it is more of test cases in terms of what has actually been done...there is no case law it is not a given that when it goes into business rescue obviously success will be quickly forthcoming.

FIN4: "There is no doubt that people will take advantage if they see gaps. This is human nature and I have experienced it, people will take advantage of the law. They do that every day and that is why the law has evolved over however many years, this is a new law and so it is going to have gaps and people are going to take them...That is what we see in day to day that people are definitely using it to their advantage to buy time, to buy themselves a moratorium, there is no doubt. A lot of them are not even operating entities, we have seen it with property owning companies - now I am saying a property owning company where there is not even an operation, and business rescue is not relevant.

FIN7: "It all depends on the trust that the bank or the creditor has got with the client on the other side; because as I say we have done it before, once we want to start legal proceedings because we do just not understand one another, and you start the legal proceedings that is when they normally say business rescue."

FIN4: "By far the majority is the companies passing resolutions; but they are not necessarily doing it voluntarily. When I say that they are being coerced or pressured into..."

FIN4: "The facilities are being called up, he is being pressurised by creditors and as a result he has put himself into business rescue. So he is being forced in other words he is not doing it of his own free will or own accord."

FIN5: "I think a lot of people are misusing it to - especially when you see the inevitable thing of it going into liquidation, again a lot of the time from advisors, legal or financial, people that just say file for business rescue, but they don't understand the impact. Again the main impact is funding, who is going to fund this thing. It is easy to say file for business rescue and then they can't defect or they can't apply for liquidation or things, so I think it is a first response, file for business rescue. Although you always have the option if someone files to still approach court and say it is not really a protection for them, well I say approach court you officially have to go through motions. Like I said earlier in most cases you find that they first of all don't comply with the time periods; so I almost want to say in most cases if they file and you still want to liquidate, you will find reason to liquidate it because they don't comply with the requirements."

FIN7: "Exactly, and at the end of the day they are still going to go into liquidation and how much money do they owe the business rescue practitioner, and that's what they don't work out. Attorneys are advising clients incorrectly as well."

FIN6: "Generally speaking as banks we are very reluctant to offer funding to a project which is actually going down. There are very extreme cases where the injection of some working capital could actually trigger the turnaround of a company; those are very extreme situations where we would probably be more inclined to actually put in the money as banks."

## Nature of PCF in South Africa

### Responses from BRPs

#### Definition of PCF and mechanisms for PCF

BRP1: "Some clarity on what is post commencement financing and some security on it, because it would be a lot easier if everyone knew that at the moment for instance in practice it is unclear as to whether people want to a stamp on the notice and the access file it and push it through the slot and it is fine."

BRP3: "You have got pre-business rescue creditors, then you have got post commencement financiers, let's call them that; they are dealt with in the plan. Once the plan is voted in, in terms of 154, there is a discharge of all creditors' claims at whatever the compromised amount is...So suppliers who continue to supply a company after commencement are also deemed and are treated by practitioners as post commencement financiers that is correct. So anyone that continues to supply goods "on credit" post business rescue filing also get elevated into that, has to be because no one is going to really want to continue trading with the company unless they get some outcome in the business rescue."

BRP4: "In the old Act Section 339 it was there, it said if your liabilities exceed your assets, but in the new Act there is nothing like that, and in the liquidity it says or not be able to pay your creditors in the next six months, immediately or in the next six months. Now that is quite simple, there is no terminology like insolvent; so yes that is also a loophole in the Act, it has got to be defined, insolvent needs to be clearly defined."

BRP1: "It depends on the situation; it is a bit like a game of snooker - all the balls are on the same spot but every game is always slightly different; so you have just got to look at the situation and scenario and what the key points are and what the key [peak points] are, what the releases are and that is where the problem is."

#### Typical Financiers of PCF

- Banks

BRP2: "So I think there is a lot of neglect on the part of the banks on knowing what their securities are, and they are also partly to blame. Maybe it is a staffing problem of the way the banks are staffed and the resourcing."

BRP5: "The banks will do it under certain circumstances when their own security is under threat and they almost have to protect an asset...Yes it is defensive, but they have said, they have expressed a willingness to play but it has all been lip service so far."

BRP7: "Generally I have found that the bank who is involved in the absence of the shareholder or another major creditor putting up post commencement funding, there is nobody else to put it up...No the banks, I have been involved with...they have all been willing to put up post commencement finance...Well these are credit people and they will evaluate whether there is a good chance of success or whether it is just time to cut your losses and throw good money after bad, but the easiest thing is to always criticize banks or major creditors that they don't do more. But even the capitalist society most of these companies have got as their state of objective to maximize shareholders' wealth and you have to be mindful of that; so if you have a pure social agenda and you want to save jobs irrespective of whether the company is going to survive or not survive, you get your money back or not that is different. I wouldn't expect that major creditors or banks would simply take money and toss it unless they believe they have a reasonable chance of getting it back."

BRP10: "I think the banks are the easy or the quick answer but they are not going to just rush out, in cases that merit it they will consider it."

- Trade Creditors

BRP1: "A lot of time suppliers have got an interest in making sure the business continues because they are either going to write off a whole lot and they are not going to have somebody else to supply to."

BRP2: "There is one thing I do notice with concurrent trade creditors here they are more in the favour of business rescue because of the prospects of them of getting more."

BRP4: "What I experience from your trade creditors is that they are prepared to support the company, immediately they go to a COD basis but where they are prepared to do it on a 30 day term they are interested in debt equity swops or whatever the case may be. They want a piece of the business...So they understand the business rescue concept because they are in business themselves...So they know each other, they understand business; they know the problems you go through etc. So they want to understand the measures that are in place to get their old debt back and their new supplies they want to be paid within 30 days or on a COD basis. So they are happy to continue with the business, supporting the business or whatever the case may be; even if they don't get any money out of it because if there is life in the business they have got future business."

BRP5: "You must understand that every supplier who supplies post business rescue is in fact a post commencement financier...Trade creditors from what I have seen, where a company in a business rescue is a strategic supplier to them, they would just keep on doing business with these guys. They often take a 15c in the Rand on the outstanding with a smile."

BRP6: "It only happens if the practitioner in my case managed the business, they didn't trust existing management...they trusted me and they worked... then they would give credit."

BRP8: "And I make the creditors then participate in profits instead of just getting the account going...they're happy to say ok we settle at ten cents in the Rand on condition if you're viable again we have a recall on the debt. And that's post commencing type of finance."

BRP8: "What we do these days is we go and look at who's in the same industry. Say who would you want to take over your plant...We do a consolidation in the industry."

BRP9: "It is outside, it was competition because they strategically did it so that they could take over those client bases; but those things you need to think about because your competition is always sometimes the one that comes and saves you."

BRP10: "Yes the creditors for them to vote on the plan or even consider post commencement finance they want to know to some sort of degree of certainty of where things are going to go, they are not just going to throw money into a black hole. So unless they know where it is going they would rather stick with their position...but to go to the wider body of creditors some cases have got hundreds or thousands of creditors and you have then got to go and select on the basis of the essential creditors and non-essential and [view] it on that basis. I think the creditors are generally uneducated or unsophisticated in this type of field and they just don't understand the process, so they'll say go to the bank."

- Customers

BRP1: "Customers are a route that is often overlooked but it depends on the business though. Again the customers might like the product so much that they are prepared to put some money in, or they need it and it is absolutely key for their product."

- Shareholders

BRP1: "Shareholders especially if it is a family business..."

BRP4: "Most of the financing comes from the shareholders as post commencement funding...mostly in the form of a loan account, and because they want to keep it separate it is clearly labeled post commencement funding in their loan account. It carries a different priority so they want to see it separate from their normal loan account...Now there the shareholders, those that comes to the party, they are either fools or they know something we don't but it is very rare for one of the shareholders to put up security."

BRP5: "The problem with shareholders is that most of these normal run of the mill business rescues, by the time you get there the shareholder is pretty much down and out, he is so tired he can't think straight anymore, he is at the end of his tether and this is his last throw of the dice...we now take cession of all your claims as shareholders so we have got a big fat loan account; that is typically how it would work in certain instances."

BRP6: "I got the funding from the clients where both of their shareholders ended up being obstructive and difficult and it's a major problem because the psychology of the shareholders are that when they think there is a half a chance that things might look better in the business then they do their darndest to try and claw the business back, and it's one of the fundamental

problems with business rescue. You cannot continue having a situation where your shareholders have an option to derail the business rescue.”

BRP7: “If they’ve got money but with most of these cases, or certainly the cases I have dealt with the shareholders and they haven’t had the funds to put more money into the business...Shareholders may decide enough is enough they want to pull the curtain down or, this business is never going to be a business, we thought it was a business it’s not a business, time to exit the business.”

BRP8: “Last resource is where you go to a shareholder and ask him to pump in more money...And I’ve had a shareholder pump in money on the condition that all other shareholders walk.”

BRP9: “The one business that we were involved in was a private individual that gave post commencement funding - what they get in return is a major part of the shares; so the transactions that I am working with is using a shared dilution...a big factor is are the shareholders also directors; if the shareholders are not directors they don’t want to give funding, not interested. They want to cut their losses; if the shareholders are directors as well then the chances are better.”

BRP10: “So that has happened but shareholders, if it’s a small shareholder body then yes you can get that done but for a listed entity it is very difficult to get shareholders to put money in...If I know that the shareholders are going to recapitalize I would give you bridging finance until the recapitalization takes place. But then it is chicken and egg, can you get the commitments from the shareholders before the collapse comes.”

- Development Finance Institutions

BRP4: “Okay my experience with the IDC is that they will most probably come in as the post commencement funder of the future. They will have to go through a serious evolution to adapt to the time constraints of what is required in Chapter 6 in terms of the law. I think they are in a good position to actually distribute government funds, the millions that Zuma has made available for distressed businesses; but unfortunately their internal controls, they are very internally focused still and I haven’t got three months for them to do due diligence, I have got ten days to do my own. So obviously I know where to go to and I am prepared to pay a premium for post commencement funding but I need it like yesterday, and IDC is not there, they are not close to it. Development Bank of South Africa, also too conservative, too much red tape, they wanted to appoint me for a business rescue, they wanted me to do a tender, go through a tender process, put a plan up, do all the work and then you are only in the tender phase. I mean it is not worth it.”

BRP5: “It is the bureaucracy, it is the absolute bureaucracy - you would look at a guy in the eye across the table and he would understand exactly and he would have all the will in the world, but the systems internally don’t allow him to pursue it...It doesn’t make sense for me when you are an organization that is supposed to save businesses and jobs and you disuse your organization that you cannot take quick decisions. You have got to be able to move swiftly.”

BRP7: “And of course it will increase dramatically, dramatically if the IDC had to turn around and say listen I am taking R5 billion which is nothing for the IDC and putting that into a high risk business rescue post commencement fund to preserve jobs. That would be the industry the very next day... They would make it available to a practitioner - they are the only people they can make it available to, or they could make it available to commercial banks, give a billion Rand to each commercial bank and say use this for post commencement funding of your matters, they could do it like that. That is maybe a way to really kick start post commencement financing - the DBSA, IDC, social agenda versus for profit.”

- Alternative Financiers: Distressed Lenders and Private Equity Firms

BRP5: “The typical players would be venture capitalists and people who have an appetite to have a higher risk and a higher return type situation. It is not panned out fully in South Africa, it is not developed yet; there is lots of talk about creating an equity fund and whatever but that is just ideas that are just mulling around at the moment. Everybody talks about it but no one has really gotten down to actually bed it down. You are going to have to find an almost legally run fund with a board of governors or some form of board empowered to take decisions, you are going to have to have the people who are prepared to write the cheques, put the money in the fund and leave it to other guys to make the decisions. That is a tough call because having seen what is just happening with these funds where you get unscrupulous operators I think there is going to be a lot of aversion still. There are a lot of people sitting checking out how it is working and waiting for people to burn their fingers.”

BRP4: “People will start learning that it is not that bad and as we go through the learning experiences that will pull people to the market. A lot of people phone me and say how do we go about forming a distress investment company, we have got investors, we have got people who want to chance this and put some money in there and invest in a high risk environment. So obviously there are people who want to take the chance on distress investments.”

## Responses from Financiers

### Definition of PCF and mechanisms for PCF

FIN1: “There is that whole debate, does post commencement finance have to form part of the plan or can you give it outside the plan. We have seen that you can give it outside, but obviously then if the plan is not approved you run the risk of letting it go into liquidation so you have to be careful around that and giving it straight away or not.”

FIN2: The contradiction in the law and peoples interpretation, and I had an argument about it a few days ago, is that there is a six month clause that within six months... I don’t believe that is true in any word. I think there is an error in my view...I am saying that it is intended that within six months or if a company cannot pay its debts in six months it is no longer a growing concern you have a reporting responsibility. Once you come up with a business rescue plan, the business rescue plan needs to be something that can work over time and return the company to sustainability not necessarily profitability but sustainability, but not in six months. I think the six months was intended, maybe I read it wrong, but I think the six months was probably intended not to drag out the entire process. So if for example you have a process which is approved, maybe you can take it out of business rescue in six months, but not necessarily have the company profitable and sustainable in six months.”

### Typical Financiers of PCF

- Banks

FIN3: "If the banks feel like there is something salvageable there and they believe the management."

FIN4: "I think generally we are too conservative, so I think maybe offshoots of banks or separate created divisions of banks as we do have, we have equity arms and then other role players...who would have more of an equity appetite because it is in that space...that is really the risk domain that I believe this will evolve to, there is no question, but in our space no. We are just too conservative, we need security and so forth, there is not an equity appetite. Although we have had instances where we have provided it knowing full well though that there is light at the end of the tunnel. So it is not as though we don't, we will look at it... there are policies and you name it that we are governed by and it is very strict. In these instances we provided it by way of additional overdraft funding so yes it has been in that space."

FIN4: "So I am saying we don't deal with business rescue just by the way separately, we don't have a specialist unit or whatever, it is part of our business as usual process although we had to go through quite a significant education process - both from a legal point of view and training...Engaging with other creditors, that is not a normal thing for the majority of bankers, we don't usually engage with other creditors, employees, it is not easy engaging with employees and how they operate. So we had to really go through quite a significant educational process, but fundamentally we are very knowledgeable when it comes to lending money, assessing the viability of businesses, that is what we do and we have been doing that for a long time."

FIN4: "The macro force is going to happen; but the question I always raise with us is what happens if we weren't there, then the effect would have been a lot worse. That is really in terms of the role we play...We are an offshoot of the credit function but we are much more intensive, we engage with clients, whereas in the normal credit space they don't usually."

FIN5: "So if I compare it to South Africa I mean from our experience now we don't have a separate product or policy or anything about post commencement finance...When we deal with the business rescues we deal with it in terms of our normal credit policy."

FIN6: "Principally I think it will be your banks that are already exposed to the project...so you have got to assess each of the options to see where you can actually recover more - but of course equity is not the first choice, for a lender that is not the first choice. You ideally want to be able to still hold some loans in the business and ensure you can recover as quickly as possible. But sometimes there are situations where you are forced by the circumstances to actually take equity."

FIN8: "What you need from the banks is flexibility, so you say to them can you defer or can we renegotiate the terms here or will you take a write down of some of your investment, rather than them putting in new money... So you don't often see the banks putting in new cash, they will convert debt [to] equity ... because if the shareholders won't put more money in then they convert aggressively...I think to get new bank debt in is often difficult; then you say well if you say go up the tree, is there mezzanine debt, yes but it comes at a massive price. Then shareholders and the business must say can we withstand this kind of debt at this kind of price because they will come with aggressive terms."

- Trade Creditors

FIN1: "Trade creditors yes; so what some practitioners do is they say okay for the debt prior to business rescue you will follow the normal process but post commencement we will pay you COD on a 30 day basis or whatever and then they will negotiate those terms because otherwise they can't operate; so they do need to make some negotiations with them and it depends if some are willing to and others are so cross that they just say no or they can't to cripple their own business."

FIN2: "The second phase is basically the assessment of the business to the business rescue plan stage...generally provided by the creditors."

FIN3: "So vendors tend to take sort of a haircut if you will, defer or delay payments."

FIN5: "If this period is fairly short and you can convince them [creditors] to provide this interim funding until you approve the plan; to explain to them...that if the plan goes ahead, post this if the business survives, obviously you retain your client and you are going to make additional business from them in future."

FIN6: "It is not very common for a lot of our creditors... But just for traditional creditors half the time they don't play in that space."

FIN7: "Creditors on the other hand or trade creditors are probably asked to continue with supplying."

- Shareholders

FIN1: "Shareholders they have put in but the ones we are seeing are owner managed businesses, so they don't have the money to put in. They have bonded their house and they have done everything they can and they have put all the money in and then they go into business rescue; it is too late. The bigger ones yes I think they have put in a bit of money...So there are if there is a business but the ones we are seeing are so dead anyway there is hardly anything left to save."

FIN3: "So in many cases the shareholders could or would advance capital generally under duress from the banks who are saying you need to recapitalize this business...If the shareholders feel that at some point in time they are completely under water and it's not worth it walk away from it and leave it to the banks."

FIN4: "The shareholders are going to get nothing... although the shareholders have also injected loan accounts so they will get some of their loan accounts. Then another one too where it was also an acquisition that was done through the business rescue process. Shareholders and directors are not happy but the business has survived; so some of them have retained their positions but others have not."

FIN6: "He wouldn't go to shareholders, shareholders in business rescue don't have any power and half the time they are the biggest losers. I think it protects more the creditors than the shareholders. Unless the plan has got a significant upside for shareholders which half the time it does not."

FIN8: "Shareholders, it has to be because the people with the first claim to the assets are probably the creditors and then the banks are very well secured...because if the shareholders won't put more money in then they convert aggressively. That is why the shareholders have to come with cash to stay in the game really and to get their return back up again; otherwise they have to walk away from the asset...Alternatively it is shareholders money, existing shareholders money or new money and as I said earlier when new money comes it is often in a deeply discounted rights issue which is penal to anyone who has been there before; and that is why you get the old shareholders often come to the party...It is up to the existing shareholders to make a plan otherwise someone else takes control of it; and that has been the key lesson is you can pre and post if you want to be in the post commencement finance game of a business you need to take control, get in, jump in and take charge of processes, putting in new capital, appointing management decisions, it can't be done passively it has got to be an act of role play...Where shareholders come to the party is they are flexible... If there is nothing from the shareholders the banks are often disinterested."

- Alternative Financiers: Distressed Lenders and Private Equity Firms

FIN5: "I think where you find totally new investors comes in, their funding in terms of taking over the business and injecting will probably be after the business rescue plan. It is a huge risk for them to put in new money before the business rescue plan is approved."

FIN3: "Why bother with something risky and complicated and something that is still opaque in the court law when we can go and pick fruit elsewhere. So that is the general perception that is a little bit of the feedback that I got."

FIN8: "Yes, and they are not going to buy minority stake, they are going to want control, they are going to want to control the board, they are going to come with a whole lot of terms and conditions and they could also put a shareholder loan in there, so they will have equity and a shareholder loan which will rank ahead of anyone else again. So you get all this debt ranking ahead and then you get the mezzanine debt and then you get a preferential shareholder loan; but they are going to want to control the board, and they will dictate terms which are not aggressive but I suppose they will write in the turnaround situation, they make all the calls."

FIN7: "There are, a lot of the guys come to the bank and say have you got a book that we can buy and you sell 'voetstoets', you sell with the security and everything because the bank is allowed cede and so on its debt. We take out whatever cents to the Rand and then they do whatever they need to do. So if they want to follow the legal process to recover the debt that is their problem, we are out of it then. So that does happen."

FIN8: "I think you definitely see distressed debt funds...we have got very good examples. But everything that they do, anyone who invests in distressed companies as a newcomer whether it is in the debt or the equity, buys something at a deep discount, so that is the opportunity they see. So if a debt is at call it 100c in the Rand and they come in and buy it at 40c, they want to buy it at 40c and sell it at 80c or 100c so that is the sort of opportunity you see and that is exactly what happens in the equity space as well."

## APPENDIX 10 – DETAILED RESULTS: RESEARCH PROPOSITION THREE

FIN1: "It is not part of the plan so there is that whole debate, does post commencement finance have to form part of the plan or can you give it outside the plan. We have seen that you can give it outside, but obviously then if the plan is not approved you run the risk of letting it go into liquidation so you have to be careful around that and giving it straight away or not."

FIN2: "Now, post commencement finance by definition is only applicable to an approved and adopted business rescue plan. That comes in 30 or 40 or 50 days after that event, so the business rescue practitioner during that time doesn't have rights of borrowing unless there are unencumbered assets of the company...but he cannot provide the guarantee that there will be pay back."

### 5.6.2 Phase 1 - Critical and Emergency Funding

FIN4: "I think probably the most difficult thing for us is the post commencement finance is needed between date of business rescue and the plan. Once the plan has been formalized then it's easier to deal with any issues."

FIN2: "The shareholder and the company would probably provide the first round of funds. That first round of funds would come in from internal cash or an additional shareholder loan to establish the first phase. That first phase is from the time of business rescue to the time of getting the creditors together, the first meeting...So the first phase is establishing the business rescue."

### 5.6.3 Phase 2 - Pre-Plan Funding

FIN6: "What can I quickly fix so that I can make money immediately. That is where they will need cash...normally it is not a lot of money where you are just trying to make sure that if it was just producing a set of products so that we can deliver...you are more inclined to say let me pump in money to that activity which is realizing most value...Once you have focused on the short term issues then you are looking at the medium and long term issues."

FIN5: "What business can survive without doing business for three months; by the time you get here then there is no business to continue with. I think this is the essential part to get this funding, between filing and approval of the plan."

FIN3: "At the 90 day financing mark you either know you have to shoot this thing in the head or you can do something with it. That is what is missing in our legislation too is this check point after a certain period of time."

### 5.6.4 Phase 3 - Post Plan Exit Funding

FIN2: "However post commencement financiers need to be very well aware that [in] the post commencement plan you cannot provide short term funding for long term assets. So if the business rescue plan is actually a complete turnaround of the business where there [are] additional assets, new business model...and those things will only take three to five years to show any return - the business rescue practitioner needs to advise and apply on the basis of post commencement finance but on that long stage."

## APPENDIX 11 – DETAILED RESULTS: RESEARCH PROPOSITION FOUR

### 5.7.2 The availability of security

#### Responses from BRPs

*BRP1: “No no you have got to find some security somewhere because you can’t go to anyone and say this is an unsecured facility on a distressed business because that will never fly. There has to be some asset in there which has some headroom.”*

*BRP7: “You are either investing in a dream or you are investing like a pawn broker against good tangible security. Not that many people are investing in dreams; there are people who are investing against security, that is the main phase at the moment.”*

#### Responses from Financiers

*FIN1: “When there is security; so I think if there is proper tangible security that they can offer which in the cases we have seen there’s nothing. By that point they have used it all and that is why your invoices are the only ones that you can basically use. So if there is a property or something then they would rather sell that within the process and use those funds than getting a bond or something where we can take the security.”*

*FIN4: “So there is a premium and the same thing should apply with post commencement finance unless you really for example are getting good security. But if there was good security someone else has got it and it’s usually us as a bank; so normally the bank has the better security, not always but generally speaking we have got it.”*

*FIN4: “There are only a few instances where we have done it - we already hold that security so we are really diluting our security purely to gain an advantage and that is why I say there has to be some advantage...We are just too conservative, we need security and so forth, there is not an equity appetite...In an improving environment where we have got more than sufficient security we may say fine we will give post commencement finance because we know even in a liquidation we are going to recover our money.”*

*FIN5: “Obviously whoever is the holder of the security at this stage they are not going to weaken their position during the business rescue, they are just going to sit tight, they 10:1 are not getting any repayments on that bond in the interim... in most cases you will find that if you have a bond you will just sit with it until you see what the outcome is of the plan or you have revoked the plan. So in terms of post commencement finance debtors is probably the easiest one. Almost similar to invoicing discounting facility where you say we will do it but only against actual debtors that is generated; we will discount the invoices and [that sort of thing].”*

*FIN6: “Essentially I think the starting point for lending money is the soundness of the business and the model. Security is an additional; you don’t lend money because there is good quality security that is not the principle. You have got to lend money because it makes business sense; so the first step is to make sure that you are happy with the business and you are happy with the financial model. Then as a secondary now to support and minimize the risk that was has been projected does not happen, that is when you then look at the issue of security. So you can’t lend just because someone has got wonderful security, you can’t lend to them on that basis...so it is normally your blue chip companies that you...could probably give funding without any security. But for projects in business rescue I am sure you will want your security.”*

### 5.7.3 The impact of the profile and actions of the Business rescue practitioner

#### Responses from BRPs

*BRP5: “I think the ability of the practitioner to provide a proper analysis of the liquidation scenario, because if you are at sea when it comes to understanding the laws of insolvency and how people would rank, then there is no way that you can present anything to prospective financiers that will give the guy confidence to put the money in.”*

*BRP7: “Well imagine you wake up one morning and you decide to go and get a bank overdraft, run a business that is in distress and the bank doesn’t have a clue who you are, they do not know what your qualifications are, they do not know what your experience is, they have no understanding of your track record - what do you think your chances are of being able to successfully access money, why would people give you money?”*

*BRP5: “You have got to be able to predict from your own experience how this thing will pan out going forward. If you can say quite confidently look this is how it will be, and you can convince that financier listen give us that bridge because there is the bit of fat that I can tell you from 30 years’ experience.”*

*BRP10: “Whether you like it or not relationships also come into the equation; if whoever is going to put the funding in is comfortable with the jockey then that is already a hurdle that you have overcome. But if they are not comfortable with whoever the practitioner is then I think your chances of raising post commencement finance is gone.”*

*BRP9: “My experience is that there are other practitioners that have come right with banks that is because they have long standing relationships.”*

BRP10: "I think relationships also come into play there, if the banks know the individual involved it would invariably begin to prepare to rely on credibility and reputation and say okay well I know you and here is something just to keep things going and keep me informed."

#### Responses from Financiers

FIN1: "He says that he will not take one unless he has done a pre-assessment. He is not willing to risk because they take on a risk themselves so they can't just be appointed on something that they have no idea about, and then they try to convince the banks that it is a good idea etc. They need to buy into it before so that they can sell it to everyone else basically...I think a pre-assessment is essential."

FIN6: "It is critical I think for the practitioner to be able to understand where the business is at, is there further scope for it continuing to grow, is this a market which is growing or is it a stagnant market or a market which is going down and how do you develop when the market is actually going down. You would probably need to sell some of the business and ensure that what you remain with can supply the smaller market; so I think those are the various aspects that would be very key."

FIN5: "Also I think in the day to day involvement in a business rescue is much more involved. We have a couple of liquidators that also did business rescues for us, and even they acknowledge that it is not like a liquidation where you sort of from the sideline manage the process; it is every day, you are responsible for it with the board. So the FD or the sweeper or the tea lady, she phones you and asks if she can buy coffee and tea, it is a daily involvement."

FIN6: "Yes; as a business rescue practitioner you have got to come with a track record that gives confidence to the affected parties, that you can actually turn around the situation. If you are a no-name practitioner it is very difficult I think."

FIN6: "So obviously the quality of the practitioner in terms of the skillset for the particular assignment, I think it will come in very handy in terms of trying to raise the funding."

FIN2: "Over time it should be a non-issue because the process should be as such that a business rescue practitioner's ability to come up with the plan should be assisting, not necessarily the business rescue practitioner. However there are certain people...that we won't use again and we shouldn't appoint those, obviously will come through the wash I can almost guarantee that...so at this stage it matters who brings it through."

FIN6: "Of course ordinarily remember the practitioner is appointed as an individual but obviously I am sure he will also have his own team that he works with, obviously if he has got a sound team because he has got to assemble people that will help him ensure that he can deliver. If the team is well meaning and well sound in terms of the extent of the skills required, on the job I am sure it will actually help in raising the funding."

FIN1: "There needs to be control so the practitioner needs to have a team of people, financial people and legal people and operational people. A practitioner doesn't understand a bottling plant or a paint manufacturer or whatever, they don't know so they need someone in there who actually understands and that will be to the success of the business. So they can look at it all on paper and see oh we made a profit today or we didn't or whatever, but actually you need some skills and no one person is going to have all of that. So either along with the current directors, and if it can be a team thing that is probably the best thing if the directors are in there with their business's intentions at heart and not their own, then it probably is the best thing to work with current management. Otherwise getting some people in there with the right skills."

FIN5: "I think if you are upfront the practitioner realizes the practical impact and what he needs to do, and what is required, then it should be easier to arrange the necessary funding, have a plan and all of those things well in advance."

FIN3: "It gives all the power to the liquidator [BRP] and it doesn't [fundamentally] try to protect the interests of the company....Then secondly that post commencement financing needs to be provided by somebody that knows what they are doing. In a sense that that post commencement financier needs to then have an active seat at the creditors table, and the ability to influence the outcome of the broader restructuring, that is where mainly the merger of the liquidator [BRP] and the post commencement financing needs to come about and you get rid of agency theory. So in fact the post commencement financier, the one who is taking the biggest risk here, should be the one driving the boat and being able to have the power to say hey Mr Bank you have been naughty, back off or you creditor or you management should not be in an agency position. The liquidator [BRP] today is in too much of an agency position, so maybe the solution here would be that the liquidator [BRP] appointed must be the provider of post commencement financing. He can't be appointed unless he can provide post commencement financing."

FIN5: Yes, so I think the practitioners have a really big role in success of the business rescue. Also because it is new I think we have a lot of people that perhaps get a surprise when they are appointed to see what is involved. I think the sooner they have the new accreditation or board or whatever they want to have the better to have definite standards there.

#### 5.7.4 Financiers require a sustainable plan based on a viable business

##### Responses from BRPs

BRP3: "So in the bigger ones I think the banks generally would say if there is a sustainable plan and our bank's policy is yes... then you will see post commencement finance...but in the right ones they will support it...where they see value and they see an opportunity for it to be turned around in the process."

BRP9: "If you can prove that the current business model failed because of management then it is a business you want to save. That means that there is nothing wrong with the business model; but if the business model sucks then you have to maybe re-engineer the business model."

BRP1: "So if you are wanting to loan this money from any business so it is a successful business and it starts up, and you approach a funder and they want to see projections and cash flow forecasts; if you are going to ask somebody for financing in a business rescue they want to see the same things."

BRP7: “Understanding of the business, confidence in the practitioner, confidence in the plan, you know business rescue is all about the plan, you have to have a plan and if it’s not a credible plan or one that you have got confidence in why would you put your money into the plan.”

#### Responses from Financiers

FIN4: “I think the critical or the main reason would be that we need to be convinced that this company is salvageable, so that is the primary reason and we would already have some history of that. So we would already know whether we believe at the point of business rescue and shortly thereafter, we would just want confirmation of that from the practitioner; because now you have got an independent person hopefully and I say hopefully because he is not always independent (that is another issue) that he is going to assess it and say right yes this is salvageable.”

FIN5: “That is where the business plan comes in, because obviously whatever they have been doing up to now to get them there wasn’t working so you have to see what is going to change, what is going to be different. I almost want to equate it to a new client walking in the door and we say give us your business plan; I mean the rescue plan is sort of the new business plan.”

FIN7: “I think from the bank’s point of view we would like to see a bit of a business plan as to how do you see this business going forward, and if you say that why do you say that. We need proper full cash flow scenarios, what it’s, two three years projections going forward just so we can actually track what he is saying is going to actually happen. But it is like any business coming to the bank asking for finance, we would ask the same questions and nothing would change.”

FIN2: “A pre requisite would primarily be the economic viability and sustainability of a revised business model which would drive cash flows.”

FIN2: “Not security let me start off by saying not security. The business model, I always say this to people when people tell me there is my statement of financial position I am in trouble and I say that is the last thing I look at. I don’t want to know about your balance sheet and I know people get upset and I am saying what is driving this business, your revenue line. I want to see that revenue line, so if we have comfort in the business model, the projections, the markets, we will back any restructure because you can restructure a balance sheet until you are blue in the face, how do you want to skin a cat. But that revenue line, if your product is not in demand, if you are not providing it at the right quality you are not going to get the market. And if you are not going to get the market guess what don’t put in any more money, because even if you give to the point at looking at your overheads work the other way - if there is a demand what is your inefficiency that you can’t make profit, that is the next question. Because very rarely you find people in South Africa who have a unique market as in one person or one company; so in that instance you would probably have a niche market where there are a few players, and if those few players are doing the same thing that you are doing and they are successful, let’s see from an operational perspective now where we are going wrong and generally its management....We assess security but you have to assess the risk, but our decision is not necessarily based on security. We would even be fine on 5% or 10% security.”

FIN6: “I think it is more about the business model and the financial model; the financial model has got to be sound because remember what has been bleeding the business is the financial model that was not working. So as long as the practitioner has developed a plan which results in a sustainable financial model, then you are bound to actually get funding. As long as you have got a project which has fully been interrogated which makes sense, you are bound to find the money. But as long as the model does not make sense and it is not as water tight as everyone would want, then you are in the danger of not getting any funding.”

FIN6: “Where there is demonstration that the business model and the financial model speaking to each other can result in a much better outcome, and then obviously those are the things that one would really need to take into consideration to make the decision.”

FIN8: “Anyone putting in new money...will want to look at the fundamentals of the business. If there is a decent business model, good management - and that is a critical factor...they will look at it. If the business model is over or if it’s a sunset business or it is just bad management they are not going to get people say we’ll back you.”

### 5.7.5 Distressed business should involve and engage Financiers upfront prior to filing for business rescue

#### Responses from BRPs

BRP1: “If everybody is working together, the management of the company, the bank, then they [bank] might consider it if they think it will help rescue the business...If you do business rescue by discussion with the key stakeholders before you actually go into business rescue, then you are able to work out the extent to which the existing funder will be prepared to continue financing. But just to go and look for post commencement financing out in the market, there doesn’t seem to be much of it around...So one of the prerequisites to me is the involvement of ourselves [BRPs] beforehand, before the resolution is passed.

BRP3: “Before the practitioner gets appointed... go and consult with the creditors first, do what they call a pre-assessment. If you don’t and you don’t engage with your creditors, (A) you won’t know whether they are going to buy into your plan ultimately; (B) you need to upfront work out whether or not there is an appetite for post commencement finance, and (C) basically is there a plan that is ultimately sustainable here or not before you even file the resolution for business rescue.”

BRP4: “I think you need to become involved before the time to see if you have got a source of post commencement funding before you file, because once you have filed you have closed the doors to everybody.”

BRP10: “But the thing is if a company in distress talks to the bank and drags them along in the process and starts business rescue with the blessing of the bank, then the chances of success are very high. But to just go into business rescue and give the bank a letter saying I am in business rescue, it is not really instilling confidence, they are definitely going to oppose it.”

BRP2: “[xx Bank] has said to me if you have got a problem rather come before and sit around a table and let’s discuss it so we know; which is more in line with the international law...I would recommend the Australian dynamic of engagement and I think your chances of post commencement finance will be a lot stronger and better, and you will know...even the Australian system I

mean post commencement finance is organized before you proceed; so if they do it on that basis in South Africa then I am sure the banks will fund.”

BRP5: “That is exactly what we have been doing in the 80s, we did ‘pre-packs’; the guys come in to your office and say look we are in severe financial dire straits but we have this buyer who is prepared to take our business. But he is not prepared to put the money in and become just a creditor, so we say okay what are the assets worth, get it valued, file for liquidation and then a week later make an offer to the liquidator. So that was a pre-packed deal. In many instances they canvassed the creditors, the bank had a material bond over the assets, they knew about the buyer, they knew about the entire strategy, it was worked out in a boardroom and then they file for liquidation, do the deal, get out of it and save the jobs.”

BRP10: “When you apply for your license...it comes back from CIPC saying here is your piece of paper that notifies you that you cannot get involved in the company until the certificate or something happens...But the fact that you are already dealing with the company may be contravening it but there is no sanction for it anywhere. In an ideal world where a company feels that it is going to go into business rescue, identify a practitioner, get the practitioner up to speed with what is going on in the company, once the practitioner is comfortable the practitioner then goes and does a post commencement finance agreement pre-commencement of business rescue, so you agree with the funder and give them all the information so that they can understand the risk and then the day you start business rescue proceedings then the next day they provide the funding.”

#### Responses from Financiers

FIN1: “We said you need to come and talk to us; and they said well where does the conflict come in. So if they go and do a pre-assessment and decide... get the banks around the table and say this is what we need, we want to go into business rescue but we need your support, we need some funding, we need this and that, are you on board...then are they independent and we say yes you are. But some people’s view is that because they have been involved in the business for a month or whatever there needs to be a fresh person who is appointed.”

### 5.7.6 Filing for business rescue by distressed businesses to take place earlier

#### Responses from BRPs

BRP3: “But talking about getting in early in the process, it is a key, it is a fundamental and that is why the definition of financial distress talks about six months, not whether you are financially distressed now, is will you become financially distressed in terms of the definition in the next six months period. Which means get in early if you are going to file for business rescue and that gives the practitioner time to raise things like post commencement finance...in theory once a company tells the world it is financially distressed you have got to have a plan or it is the death [for the business].”

BRP10: “If it had been done sort of three months earlier it would have been a lot easier to have tried to facilitate it. You go and agree some sort of process upfront with the banks to say listen I want to go into business rescue but before I do that let’s agree this is going to be the funding arrangement during business rescue, and not start business rescue and then try and negotiate, it just doesn’t work that way.”

BRP4: “So it is very important then for the business to file in good time before they are in really serious distress. That is why the definition, the definition attempted to do it but nobody is going to listen to that ‘or you are going to have a cash flow problem in the next six months’; so they want to force the people to look at their cash flow for the next six months. Now there is nobody policing that so it is not going to happen.”

#### Responses from Financiers

FIN4: “Historically and still now we are still being advised too late, whether it be deliberate or not. We have often been advised after the first meeting of creditors just by the way about business rescue; so we have already been funding... they are not necessarily notifying us, they should be in terms of the Act and in some instances we will use that as a stick against them because it’s deemed to be void if they don’t notify us within the proper time periods and so forth. The bottom line is what I am saying is that we inadvertently are funding a lot of them in any event beyond the business rescue date... without even knowing that the company is in business rescue.”

FIN5: “I think if one starts with that process earlier obviously you have a bit more options as well; once you file for business rescue obviously it is almost like a provisional liquidation, the word is out there in the market. So even with your existing clients you find it tougher, all your creditors know about it, your staff knows about it, all the potential investors or potential funders just wait for the liquidation to pick up the bargain.”

FIN6: “That particular aspect of course is a function of the timing of when you actually go into business rescue; half the time companies will agree to go into business rescue when it is too late. They never tell you their problems until they are having to fight fires. We always tell clients look we are here to work with you, if you tell me that there is a problem coming up and I work with you, half the time we can solve it. But half the time even if they are almost about to bend their office they will tell you no things are fine - so by the time they actually come to you it is already too late.”

### 5.7.7 Relationship of financier with management (and the BRP): Trust, Openness and Transparency

#### Responses from BRPs

BRP8: “A success factor is also, another thing important for financing is the management qualities that you inherit with the business rescue. Did you inherit rubbish? And do you retain them?”

#### Responses from Financiers

FIN1: "We want transparency and we want communication and then we are willing to work with you. But as soon as they are dodgy or we are not sure about their integrity or whatever we are really not interested in working with them."

FIN3: "The rescue process here I think should be much more visible, much more transparent, far less power to the restructuring consultant and the lawyers and far more in the public view of the judge who can then make nice and rational decisions...The headline is that there needs to be a lot more clarity and certainty in the business rescue process to formalize, and when you formalize it you are going to see results."

#### 5.7.8 Existence of another financial backer / potential buyer

##### Responses from BRPs

BRP10: "If I know that the shareholders are going to recapitalize I would give you bridging finance until the recapitalization takes place. But then it is chicken and egg, can you get the commitments from the shareholders before the collapse comes...I think the single biggest reason why it worked is that you had a financial backer on day one...they were willing to fund that compromise and fund the turnaround of the business. But they would only fund the turnaround if the creditors accepted the compromise; so as soon as you have got somebody with a cheque, the chances of successful business rescue just rocket."

BRP2: "So basically what you could do in the business rescue is you could get post commencement finance if you already have a suitor for the business or an equity partner, because they would come in with the idea to be post commencement finance."

##### Responses from Financiers

FIN1: "As a bank if someone was willing to put money in a company we would support it so much more."

FIN4: "We said in order to provide post commencement finance we need to know that there is a player and then obviously they came on board and then we were prepared to take a risk. We provided it in both instances without additional security but knowing full well that we will have some form of preferential claim."

#### 5.7.9 Other prerequisites for success

##### The risk of losing more if they don't provide funding

FIN5: "Obviously if the banker [sees] our position it is not always the ideal situation, sometimes you have to agree to the business rescue position if you are in a certain situation. If we would prefer to exit at that point but we have a higher risk in exiting here than seeing the process through, we might consider the better option being to see the process through."

FIN5: "I think it is mainly in cases where we have to manage our own risk where if our return is better by going through this process than it would be in a liquidation; then I think we would go that route."

BRP10: "Yes so before the practitioner actually takes on or allows post commencement financing I think they have got to keep doing that calculation or estimation of what is the dividend to creditors going to be."

##### To protect or preserve their existing security

BRP5: "They knew that if the company went into liquidation their book debts would be compromised or tainted or incapable of being collected, they knew that they would have a huge staff bill to pick up if we had to retrench all the people, and in order just to protect their notarial bond which they had over computer equipment and IT equipment ...they had to advance the money in order to keep the business afloat, in order to protect the value of their security."

BRP10: "No I doubt it because I suppose it is a percentages game, if the bank has got an exposure of R100 to R200 million then they are prepared to put a couple of million at stake just to try and protect that. If you only have a couple of hundred thousand or a million or so that is not worth the effort."

##### The value and commercial viability of additional financing is visible and certainty of being repaid

FIN6: "Just as a rule of thumb you wouldn't want to put in money into a business which is not working. So the best thing is if the model has been really worked on such that there are more significant returns that can be realized as opposed to the state it was in before. Obviously you will be able to begrudgingly offer funding to that operation, but it is not something that you would want to do. You would rather focus on a new project and give them money rather than focus on a project which has not been working and give them more money. It is not easy to offer them new finance."

BRP7: "I don't see it as a problem subject to it being warranted, who would take money and throw it after a bad debt unless they think they are going to get their money back."

BRP10: "I think there should be some sort of certainty that whoever is putting the money in is going to be able to get it back, or maybe not certainty but a very high likelihood of it being repaid; because if they can't overcome that then nobody is going to put money in unless the return is so high that they make enough that they don't lose capital."

## APPENDIX 12 – DETAILED RESULTS: RESEARCH PROPOSITION FIVE

### 5.8.2 The impact of the profile and actions of the Business rescue practitioner

#### Responses from BRPs

*BRP3: “So the wrong practitioner can put this company into business rescue and ultimately push it into liquidation just because he wants to trade it for a while in business rescue, earn the fees, no real full process about post commencement finance, it goes into liquidation and his mate takes the liquidation appointment, don’t think it doesn’t happen, very dangerous because it will taint the buy in by the banks for example in the process which is dangerous.”*

*BRP4: “They should go into liquidation and then they file for Chapter 6 and everybody sits there and the business rescue practitioner in those first ten days should say listen call it a day, we are out of here, it is done, there is no business. Once again up skilling of the business rescue practitioner, greed is the other part of it because if you look at the fees these guys charge it is serious, but while it is not regulated let’s clap the industry that kind of mindset, but that is also a problem. Because they are greedy they want to stick around and see how much they can get out of the company, because in a liquidation situation you have got top priority with your fees again so charge as much as possible if it goes into liquidation, you are top of the list.”*

*BRP4: “Your biggest problem is if you are a distress investor you have got no control of the appointment of the business rescue practitioner. I think that is one of the key considerations when investing into a distressed company, who is the business rescue practitioner; because we have got so many flyby night practitioners at this stage with all due respect.”*

*BRP4: “So it is totally different to South Africa, now that also helps the industry in the sense that you won’t have a practitioner taking on 150 odd rescue cases, they are too dedicated to one or two, because you can’t take over the management and still run with 100 odd turnarounds and do a proper job, you just can’t. That is also a problem with the regulations, your regulations should restrict you to I would say five business rescues at one time in a supervisory capacity as it stands in the Act now.”*

*BRP5: “It is quite strange that you afforded a license to practice as a practitioner and you are subject to a regulatory body, but the moment the thing goes into liquidation you can hand it over to somebody who is part of an unregulated profession. Some practitioners aren’t regulated in this country, anybody can be a liquidator... It is actually foolish.”*

*BRP7: “Who is asking for it and what are they asking for in terms of post commencement funding - you have got some schmuck who you have never met before in your life who used to be a liquidator, he is telling you he is now going to save this business, there is no track record, there is no skillset other than doing liquidations or nothing. Now he is going to save this business, you don’t know who he is, you don’t know what his integrity is, you don’t know where he comes from or where he is going and now you are going to give him money - are you going to do it?”*

*BRP9: “The one aspect that [messed] it up was that they put in the regulations that an attorney can become a business rescue practitioner. They made it a legal thing, they leverage on that because a glorified liquidation, business rescue is easier because only one business rescue practitioner is appointed...So it is being misused by attorneys but it is going to sort itself out. As soon as there is a regulatory body governing practitioners it will be all sorted out because that is why I say my clients come from attorneys. Attorneys are becoming my clients because they are realizing that it is not working exactly like what they thought.”*

*BRP7: “I mean the reality is that banks generally feel comfortable with people they have worked with previously. Someone they have got a relationship with, someone who is tried and tested and that sort of thing. I’m not saying it is impossible for somebody who has never worked with the bank to arrive and say I can do this, trust me I can walk on water, well maybe he can or maybe he can’t.”*

*BRP3: “The one interesting thing about a practitioner, you normally find the practitioner engaging with the creditors pre-business rescue. When they appoint him there is an argument that that practitioner is now tainted because he is no longer independent. My view...is that that can never be the intention of the Act. The Act says appoint someone who is independent not related to the company, not related to directors, certainly don’t appoint a non-executive director, someone who is independent - the fact that he was asked to go in by a creditor to assess whether this company is good or bad for business rescue doesn’t taint his independence. I think it is reckless of directors not to do that, because once they do it without thinking about it we have already discussed what the outcomes could be, and I think that is dangerous because then you are opening yourself up as a director to claims maybe in liquidation against you personally...one day someone is going to challenge it on the basis that that practitioner wasn’t independent; but then it will be argued and a judgment will come out to say do you know what it is in fact necessary and then the law will be set and I don’t think it will be an issue.”*

*BRP4: “Yes, the problem at this stage is that the business rescue practitioner is only post filing of the resolution, the business rescue practitioner comes onboard. There is quite a debate about it because the independency of the business rescue practitioner is under question. A business rescue practitioner should become involved before filing of the resolution, that should be normal practice and the CIPC should change their mindset about impartiality or whatever.”*

*BRP10: “But the fact that you are already dealing with the company may be contravening it but there is no sanction for it anywhere. In an ideal world where a company feels that it is going to go into business rescue, identify a practitioner, get the practitioner up to speed with what is going on in the company, once the practitioner is comfortable the practitioner then goes and does a post commencement finance agreement pre-commencement of business rescue, so you agree with the funder and give them all the information so that they can understand the risk and then the day you start business rescue proceedings then the next day they provide the funding.”*

BRP4: “Yes it will, you know there are a lot of cowboys out there and banks have started removing them, applying for removal. I actually feel sorry for the guys, it is hell of a difficult to stay on track with all these time lines, like the plan for instance, there is just no way I can publish a plan if I haven’t spoken to all the role players.”

#### Responses from Financiers

FIN1: “The practitioners (I have a very strong view) that they don’t have the skills necessary so they don’t tell the director or whoever is putting the company in business rescue what could potentially happen; and the attorneys, the small guys can’t afford to just go and spend thousands of Rands getting legal advice. So they are making a rash decision and then getting ill advice sometimes, they are seeing it as a breathing space, let’s get a few months of moratorium and then sometimes not getting the best result that they want.”

FIN4: “Looking at what is happening elsewhere it is reasonable, but the guys are either not competent enough, they are not devoting themselves to it, in other words there needs to be more dedicated approach to a particular matter not taking on 20 or 30 matters or however many and you just juggle and outsource and you do whatever to just get the job done to get the volumes and get the revenue...Now we are taking a firmer stance regarding extensions, so we are not just agreeing to extensions now, we are saying justify it, if you can’t justify it we are going to take it up with the commission that you are not doing what you should be doing and so forth; because a lot of the guys are not actually actively involved in doing something. It is again this juggling that we get the feeling that a lot of them are too busy with other things.”

FIN4: “There needs to be more control of the practitioners, who is appointed, who they are - because what’s happening we are already raising concerns around certain practitioners that have come in and not performed. So we are saying somebody needs to deal with that.”

FIN7: “Look it can work, it is just you have got to change the mindset of the people around it because my personal view is attorneys shouldn’t be business rescue practitioners. Liquidators shouldn’t be business rescue practitioners, and 99% of them are all liquidators. Accountants, you need accountants and in my view the perfect business rescue practitioner let’s say function is somebody that has got business sense, and maybe all you need is four or five people in your little office. So you as a business rescue practitioner you run it, you make sure that you understand accounting, legal and that type of stuff, you have got a lawyer that gives you advice, you have got an accountant that will pull your finances together and you have got two or three other guys running around pulling all the information and you actually do the business plan.”

FIN1: “So if they go and do a pre-assessment and decide, then are they independent and we say yes you are. But some people’s view is that because they have been involved in the business for a month or whatever there needs to be a fresh person who is appointed. So I don’t agree with that but there seems to be a little bit of apprehension by the practitioners to do a pre-assessment and come and talk to the banks and that kind of thing.”

### 5.8.3 Distressed business should involve and engage Financiers upfront prior to filing for business rescue

#### Responses from Financiers

FIN1: “The minute we get a notification and we look at that conduct as bad, we immediately stop the account...we will stop the overdraft limit and withdraw facilities because we don’t know what is going on in the business. We would prefer them to come and talk to us and say this is the story, we are not about to close our doors but we do need a little bit of time or we need to restructure something and this is how we are going to go about it. Then we are happy and we will support them as much as we can; but when they spring it on and they say the meeting is in two days and we go and there are a million creditors who are jumping up and down, then we are not prepared to support in some of those cases.”

FIN5: “That is not happening, so you are always sort of on the back foot when you go into most of these things...I mean once they filed for business rescue, if you don’t have that relationship, the trust relationship that you thought you had is not there anymore; obviously the bank can’t take any action then in terms of defecting our debtors or bond or terrible things like that which I guess also has a certain impact on the bank, and then you have to sort of see what is available, how can you do funding, what is the plan.”

FIN4: “Then post that and that is why we say the practitioner should engage with us which he is not doing, he should be discussing with us what he sees, what his requirements are even if it’s just quick and obviously we would generally do that in the presence of the existing shareholders directors...You didn’t notify us timeously and often we will send a letter to the practitioner setting out those issues initially if he is not engaging with us. So we will send him a letter setting out all the issues that we have.”

FIN5: “My view is if I was the business rescue practitioner I won’t just go on my own and in 25 days put a plan there and hope the guys approve it, I mean that is senseless. The Act made provision for the creditors committee and all of that, that there is interaction in this period that hopefully when you get to vote on the plan everyone has already basically reached agreement.”

### 5.8.4 Business rescue filing by distressed businesses for wrong purpose and too late

#### Responses from BRPs

BRP1: “People thought they could put a company into business rescue and it would solve all their problems.”

BRP3: “But what has been happening as I said is there has been abuse, a lot of these companies file for business rescue just to get the advantage of the moratorium on claims and the banks intervene generally and they put those companies into liquidation.”

BRP10: “Well I think there is a lot of abuse at the moment and if you look at the single biggest reason why they [the banks] oppose it is the view that a lot of the business rescues that have started are companies that should go into business liquidation

rather than be rescued. The fact that it is going into business rescue is just the abuse of the process and delaying the inevitable. So they don't want to be dragged along and therefore they go and oppose it."

BRP10: "Then there is a lot of case law showing that people start the business rescue process purely to delay what is perceived to be the inevitable and maybe in the hope that something is going to come off."

BRP2: "So the purpose of business rescue if used properly would be more beneficial than to abuse the system of doing it and selling the assets like you would have done in the liquidation."

BRP4: "Absolutely; if the writing is on the wall what happens your company goes to their lawyers and the lawyers say listen everybody it going to nail you, let's file for business rescue and then they get the moratorium, nobody can nail them, the practitioner comes in, they want to try and manipulate the practitioner to do whatever they want to do, that is common cause in business rescue at this stage."

BRP2: "Yes, it is a delay tactic before liquidation and it is not going to work because we are not going to finance...So it is not like hard and fast that they won't give, they also see through the system when it is a decoy where you have done it to delay."

BRP10: "I think there is a lot of abuse and I think there are also a lot of grey areas in the Act and I think if you go and look at just the intent behind it, if people just focus on that rather than looking for the loopholes - the lawyers go and look for the loopholes instead of just giving effective."

#### Responses from Financiers

FIN1: "No not really, most of them have just been [giving the] notice and that is the first we hear about it. I think because most of the ones we are getting are smaller companies; they don't know, they are scared of the bank so they are doing it as a way to I don't want to say abuse the process but they are buying time. They are not doing it with the intention that business rescue was created for."

FIN1: "So they are making a rash decision and then getting ill advice sometimes, they are seeing it as a breathing space, let's get a few months of moratorium and then sometimes not getting the best result that they want."

FIN7: "So they are just taking the long way around to get to the final destination which is at the end of the day sometimes liquidation. There have however been successful business rescue turnarounds. Predominantly I would say in the middle medium business, blue chips shouldn't go into business rescue."

FIN5: "I think a lot of people are misusing it to - especially when you see the inevitable thing of it going into liquidation, again a lot of the time from advisors, legal or financial, people that just say file for business rescue, but they don't understand the impact. Again the main impact is funding, who is going to fund this thing. It is easy to say file for business rescue and then they can't defect or they can't apply for liquidation or things, so I think it is a first response, file for business rescue."

FIN4: "A lot of them are not even operating entities, we have seen it with property owning companies...and business rescue is not relevant."

FIN4: "Because of the whole cost benefit the problem we have constantly with this is to go to court can cost us a few hundred thousand quite easily in a particular matter, and then it gets delayed etc. So we would rather in a lot of the matters, and when I say that probably more than 50% currently that is happening, where we are just going to see out the process and just vote no. We have already decided before because we don't believe that that business... it is just purely a delaying tactic."

FIN6: "Half the time companies will agree to go into business rescue when it is too late. They never tell you their problems until they are having to fight fires. We always tell clients look we are here to work with you, if you tell me that there is a problem coming up and I work with you, half the time we can solve it. But half the time even if they are almost about to bend their office they will tell you no things are fine - so by the time they actually come to you it is already too late."

FIN7: "What happens in this type of environment when a client is in default of certain facilities or exposures of the bank especially in our area, somebody actually goes out and talks to the client and finds out exactly why, what the problem is, how did they get there and what we can do to assist. Now if it doesn't make sense to us to assist then the legal process starts, then we say sorry we can't help you and now we need to recover our debt by actually selling off assets, defecting our security and that type of stuff. If we can assist that is pretty much business rescue, because the guy will come to us and say listen I need X amount of money to do this, that and the next thing and if the numbers stack up nine times out of ten we don't say no we say yes we'll help you. So my view is that is where the cutoff line is, when the bank says no and they really want something to happen they say well go legal I'm going to go to business rescue. So if you can't help me the business rescue is going to come and he is going to force you to give me the money, and we still say no, and then what happens it just goes into liquidation."

#### 5.8.5 The availability of security

##### Responses from BRPs

BRP4: "It is not that easy in South Africa. Usually in South Africa your overdraft facilities are financed by a session of debtors; now when the problem starts or when you pick up the warning sign on your South African judicial debt in the banking overdraft situation your debtors are gone already; so where the banks were in a supposedly secured position they suddenly find themselves in an unsecured position, and that is why they have got this negativity as well."

##### Responses from Financiers

FIN4: "We don't see an operation we just see a property or whatever, the decision is easy, the answer is no. If there is a degree of information we can then do an assessment and that is what we do every day, we are assessing risk and the degree to which we are prepared to fund."

## 5.8.6 State of the relationship of financier with management and the BRP

### Responses from BRPs

#### Responses from Financiers

FIN8: "Its doubt, you have put doubt in the minds of people and everyone is like this, you trust people when the guy says I will deliver it tomorrow it's there tomorrow. If suddenly he's got a crisis in his business tomorrow becomes oh I think we will get it out next week, and then people say no no I can't trust you anymore and that I think creates this problem. Eventually the guy says I can't rely on you anymore I am going to find another supplier, even though it costs more or I have to import or whatever it is, a lot of this is about relationship trust confidence and positive confidence."

## 5.8.7 Financiers do not have comfort in the rescue plan based on a viable business

FIN5: "Again going back to the practitioner's responsibility, I think the quality of the plan is really poor. The plans that we are getting, if it was new business and someone put this in front of me and asked will you give me funding I would say no. It is really poor quality of rescue plans that we are seeing. I would almost say if it wasn't for the input from the bank in the ones that we approved, then it wouldn't have gone through. I mean it is not that you get a plan and you think without your input this is something that is workable."

## 5.8.8 Financier risks losing money

### Responses from BRPs

BRP2: "Post commencement finance is a problem because the banks' attitude is well we have lost X so why should we invest more, and how do we know if we are going to get paid, are we worse or better off and nine out of ten times they look at the position as worse off."

BRP4: "It is merely an ICU situation where the banks will allow post commencement funding to get into a better position or to exit a client through a formal workout."

BRP10: "But if you go through a process and the practitioner is not comfortable that if the post commencement financiers do put money in that they are not going to get it back; but the practitioner shouldn't be accepting that money and that is also part of the reason why I would close the doors. Even if I had gotten that cash in it would have sorted out one month and then the next month I would have had the same problem; and getting back to the earlier equation of creditors in liquidation versus business rescue, they would have been going backwards."

BRP7: "It's very simple people always believe that the banks should do more, the banks aren't doing enough and throughout the world there is a big anti bank bias, but the truth of the matter is if you were a shareholder in [a bank] and they were taking your funds and gambling on what were clearly poor odds, how would you feel as a shareholder?...But you can't ask people to take their hard earned savings or banks earnings and put it into speculative ventures which have little chances of success. That is why they are in business rescue."

### Responses from Financiers

FIN6: "Generally speaking as banks we are very reluctant to offer funding to a project which is actually going down. There are very extreme cases where the injection of some working capital could actually trigger the turnaround of a company; those are very extreme situations where we would probably be more inclined to actually put in the money as banks...you don't want to put in money because you are already losing money...If I was charging you 12% and then I have got to say okay maybe let's work on 11% for you to survive; I have already lost certain points in terms of my net percent for that project. So there is obviously loss of value, it might not be very high value but there is always loss that you already bear. So now when you bring in an aspect of then putting in more money it means that the potential loss at your exposure has actually increased beyond what was originally at risk. So ordinarily then just on that basis, on that rule, you wouldn't want to put in new money; but unfortunately in some transactions you have got to put in new money."

FIN4: "If we are providing post commencement finance which I need to say at the moment is rare, it is very rare we are generally not doing it. There are only a few instances where we have done it - we already hold that security so we are really diluting our security purely to gain an advantage and that is why I say there has to be some advantage."

FIN4: "Yes the debtors, that is a big issue for us because generally speaking...we have cessions of debtors and often it is included in a bond here...Now obviously the company wants to use that as the debtors get converted to cash and they want to use that cash, so that is a big debate and it is a big debate even amongst my team in terms of how debtors should be dealt with. Generally speaking when we perfect or we close up shop and we call up a facility we perfect our debtors; so we give notice to the debtors and say you will pay us and not the client, so that is part of it. Now the dilemma comes should we be taking those debtors as they come in to reduce our exposure because that is what we are entitled to and what we normally do, or should we be allowing the company...we engage with the practitioner to say look we want that to be deemed to be post commencement finance if you are going to use it...So what we are saying is if the utilization is say 8 and the limit is 10 we peg it at the 8, because now paying the 2 what are we doing, we are paying another creditor."

## 5.8.9 Business rescue culture and perceptions of business rescue in South Africa

### Responses from BRPs

BRP3: "In South Africa it...has always been creditor focused because of our history in liquidations and directors taking creditors for a ride. There is an inherent distrust between creditors and banks and management that is just historically where we are. There again it is a mind shift to start looking at the debtor company and elevating it lets rather save it than kill it."

BRP3: "Now why did they do that to try and keep liquidation and insolvency separate and not have this connotation of liquidation and insolvency in business rescue? That comes back to the mindset. You see liquidators were always looked at very circumspectly because there were a lot of issues with the Masters office and enquiries, political fallout, bribery and corruption in the liquidation industry. What the CIPC the new Company's Office doesn't want is to have the new business rescue process tainted...they want to keep that dirty word of insolvency out."

BRP4: "Because of our Insolvency Act that is so old...you have got the culture from banks where if somebody goes into liquidation they already put a name tag to the directors or whatever as the biggest [skellems] that have ever been born in South Africa. Unfortunately that mindset now applies to the business rescue as well; as soon as somebody files for business rescue with whatever intentions, the reputation is already there."

BRP4: "Yes it is the total opposite; you must remember in the United States if you are liquidated or sequestrated you can start the next day. In South Africa you have got a ten year period. Now I mean let's say the economy turns again now you have got to wait ten years before you can contribute to an already poor economy, it is ridiculous."

BRP5: "Business rescue is still an insolvency procedure. It is saving something in financial distress. If you look at the wording of the Act, it is not to do with the space where some strategists and people at Universities with MBAs play, and they want to change the culture of the company, they want to do a turnaround and this and that; that is the TMA [Turnaround Management Association] and those people, that is a different space. That is the space where things are still in place and but there are problems. Business rescue with respect I think is for 11:45pm, it is when things are really bad, that is where business rescue comes in. The emphasis in the Act is on financial distress, and that is the definition of it, financial distress...So it is a financial restructuring; and in order to understand the financial restructuring you have to understand the consequences of the failure thereof and you have got to understand the liquidation position hence the business rescue plan that you must do in terms of Section 150 which starts off with a liquidation scenario almost."

BRP2: "I think if you succeed in rescuing here you can rescue anywhere in the world. Yes because elsewhere there is a decorum and respect and there is rule of law; here anything goes...So I think as I say South Africa is a very interesting business study case and I think if you can do business rescue here you can do it on Jupiter because the mechanism or the confines in which we work are totally abnormal to normal practice."

#### Responses from Financiers

FIN4: "This is new, you don't voluntarily say I am in trouble here because if you do everyone just closes up shop, key creditors don't fund you, so that is part of the problem too...debtors need to know that if they do it they are not going to be hit on the head and that is what is happening."

FIN8: "Plus they get a reputational thing as well, when I say it is a small town South Africa is a little bit of a village and you have got to keep away from saying oh don't touch that place or don't get a job there - once something gets tagged you have got a difficult chance."

FIN2: "Over time your creditors are going to be dealing with you on a different basis, your commercial financiers are going to be dealing with you, because of the fact that business rescue exists when you are giving finance you are almost giving it at 100% risk because if you take money from me today and you go into business rescue tomorrow, I'm out on a limb. I may have voting rights but precedence also shows now that my voting rights can be put aside, so it is going to change the culture of lending also which is negative."

FIN3: "So I think what's happening is the businesses are still a little bit in the old legislation, they would just go straight to liquidation, and nobody actually sits down and thinks well actually should we go and look at post commencement financing. When you go and look at post commencement financing the senior members scream bloody murder and everybody goes no no no we won't let you do that, and so it is kind of self-defeating its own purpose. I think if the lenders would recognize post commencement financing, that the applicant could get protection in court for its seniority for post commencement financing, I think the market would rapidly expand."

### 5.8.10 Concerns and uncertainty regarding the priority ranking of PCF

#### Responses from BRPs

BRP3: "Now the Act and the legislator clearly recognized how important jobs are in South Africa and that is why they have put this in, to ensure that rather go into a business rescue to keep your workforce ticking over and we haven't yet seen trade unions take advantage of this. If you think about it, let's assume there is a wage dispute, if they were clever they would then say okay in terms of the Act there is provision which allows only trade unions and employees to ask for the financials of the company, no one else."

BRP4: "The Chapter 6 seems to be problematic for them because contrary to what you have got especially in Chapter 11 and in Canada is the preference of your post commencement funding. Our post commencement funding, your secured creditors and your preferred creditors are first in line in priority and then only the post commencement funder."

BRP6: "In fact if you could find previous drafts of the Act that is the way it was and the banks went and made a big hoo-hah to get them put back above it. That was the way it was on the first drafts of the Act before it was published, and then when it was a white paper the banks put a tremendous amount of pressure on the Department of Trade and Industry."

BRP10: "I think if you leave it the way some of the international jurisdictions are you actually prejudicing the guys who thought they were secured beforehand. Because their asset base is now depleted."

#### Responses from Financiers

FIN2: "Now in ranking above the secured financiers they themselves lose literally, even though they don't lose the right to their security they lose the right of repayment. So if things don't work the security is liquidated, post commencement finance provider gets his money and the secured creditors get the residual; so they are giving up security in a sense. So that is part of the reason why post commencement finance is not something that is on the uptake."

FIN3: "We are rescue money, we are last money in, and we want our money back before anybody else gets their money. The liquidator there said no, when it comes to dissolution of the business these claims will all be treated equally. So there is a disconnect and there is no case precedent...we would have no protection, get lumped in with everybody else, we are going to get pennies on the dollar on a prorata formula basis just like everybody else."

FIN4: "I think in terms of the practitioner and post commencement finance I think definitely you need to be given some form of preferential ranking when it comes to that because you are taking a huge risk. That is why if you look at what is happening in the States why those entities have been set up because they are highly profitable just by the way too, because they charge very high premium for funding, so they are taking almost an equity risk. So there is a premium and the same thing should apply with post commencement finance unless you really for example are getting good security."

#### 5.8.11 Banks are conservative and risk averse due to regulations such as Basel

##### Responses from BRPs

BRP10: "Because of this Basel 3 they have got all sorts of requirements that they have got to comply with...I know a lot of bank debts that are sold are dictated or the sales are pressurized or pushed because of the Basel 3 requirements. I think that from a bank point of view is probably one of the aspects that are preventing them...Yes because it all goes back to the Basel 3 on what their reserving requirements are. There is a pricing issue as well because they are not getting that return then they have got to do something."

##### Responses from Financiers

FIN5: "The banks currently deal with it in terms of our normal credit policies; so obviously the risk rating of the client is a big part of that, because I mean as you move toward the long performing portfolio obviously the bank requires a lot more capital that you have to hold for the exposure and things like that. It just doesn't make economic sense in that sense to do it in a normal banking environment; if it is nonperforming and you have to have 100% capital for your borrowings in terms of the pricing, is just going to be unaffordable to actually put it in for the bank to make a return."

FIN5: "It just doesn't make economic sense in terms of a return on equity calculation to do that."

FIN7: "I think the banks are also looking at creating a slush fund if you want to call it that for business rescue...if it is going to happen or not is another story, but obviously it is going to be subject to that regulation."

FIN4: "I think generally we are too conservative, so I think maybe offshoots of banks or separate created divisions of banks as we do have, we have equity arms and then other role players...We are conservative lenders of money...it is not the space we play in...because that is really the risk domain that I believe this will evolve to, there is no question, but in our space no. We are just too conservative, we need security and so forth, there is not an equity appetite."

#### 5.8.12 Lack of cooperation by banks during business rescue proceedings

##### Responses from BRPs

BRP3: "You would think that the banks in the right matters would prefer the companies to remain under a business rescue process than go into liquidation; liquidation is negative, it is about job loss, it is about small dividends to creditors etc. But you are finding that the banks are not necessarily pushing for business rescue...this legislation really was created to save jobs, keep businesses afloat etc."

##### Responses from Financiers

FIN4: "Our view is that no other creditor should gain an advantage over us because everyone is on the same page at day one, so why should other creditors be preferred above us, so that is another debate we have; but at the same time we may agree to peg our overdraft at the level the facility was at on date of business rescue. That is a big debate because everyone says oh but other creditors are being paid to our detriment, because what we say is everyone has to play on the same level - there is a [concourses] in a sense at that point and everyone needs to abide by that."

FIN4: "So really we are adopting quite a firm stance regarding that in terms of funding going forward...you see it puts pressure on the company because now if we don't pay anything beyond and we start to fire cheques, debit orders what have you, what does it do, it brings people to the party...Obviously what we are generally doing now as a first point of call is taking a firm stance; so our stance has definitely shifted from the early days where we would've kept funding in place or limits in place, we are cancelling [them out]. So we are saying the utilization is your limit and we are putting a peg in the sand pending the

practitioner engaging with us. We are kind of forcing their hand because they are not communicating with us properly as they should do.”

FIN3: “The bank who won’t let the post commencement financing stick, and preserve their value. Which means they shoot themselves in the foot because what they actually end up doing is not allowing the business to do what business rescue is supposed to do, is to preserve the business and then they can get their money back.”

#### 5.8.13 Other reasons for the disinterest of financiers

##### Lack of accurate and reliable information

BRP3: “Before any post commencement financier can make a decision he has got to have information, and the information has got to come from the practitioner who in turn gets it from management and directors. If that is tainted or there has been a fraud within the company which has brought itself to a position of financial distress that creates a very negative approach by any post commencement financier.”

##### Opposing interests

BRP2: “You are dealing with human beings you are not dealing with a machine, the banks are human on the one side with emotions, the owners are emotional on the other side and you are dealing with creditors who are emotional - so they all have a different interest in the position. The owners don’t want to pay anything and they want to come out pearly white and clean, the banks don’t want to risk anything and the creditors want to get paid. So your interests are totally diametrically different, that is why there is no way that you will ever be able to put them in a box and say well that will work for everyone. It is just not possible.”

##### Lack of Regulation of Industry

FIN4: “So we have a major say in what happens, post commencement financing they don’t look to the other creditors they come and knock on our door. We play quite a significant role in influencing the process, not to say that we are saying we want to drive it.”

FIN4: “The DTI the commission needs to play a more significant role in my opinion in the sense that they need to play a role similar to the role the master plays in the case of liquidations. They have got to set the rules of the game, they have got to police it, and they have got to do all of those good things around the process and practitioners as well in particular.”

##### Distrust in the business rescue system and degree of opacity in the interpretation of the Act

BRP1: “There is a huge problem because no one actually knows what the answers are at the end of the questions; so why are other parties worried and distrust the whole business rescue because they don’t know what their position is, they don’t know what their options are and they haven’t seen it work, they want to know what is going to happen if they put more money in, they sometimes ask if there is a risk if they will have to make a contribution, if they have bridged a claim will they have to make a contribution; and some of the questions are very technical and I think you need case law to clarify them.”

##### Company Size

BRP3: “This is really a process for big companies, it doesn’t really work in smaller companies because of post commencement finance; no bank is going to put in more money when the facility is [small].”

##### Lack of awareness, education and understanding of business rescue

BRP4: “In South Africa they don’t understand moratorium. The moratorium is actually on taking legal action against the debtor, that is the only moratorium. The moratorium is not there for you now to stop making payment now for six months, that is what the business rescue practitioner is supposed to negotiate...If you stop you are in breach basically, Chapter 6 doesn’t change the breach, and it stops the action that they can take against the company in terms of the breach. So those are all factors that impact negatively against post commencement funding.”

##### Banks do not want to lose control of the process

FIN6: “So now when you are in business rescue you are no longer a creditor in control, in as much as you might be secured by other assets in the business, you are not in control. The business rescue practitioner can actually take your asset which you say is your security and use it to borrow money. They are within their rights to actually do that. So because of that then obviously my interest in putting in more money is even lower, just on that basis that I am not in control now.”

BRP4: “Let me just start off with the formal finance houses like the five banks we’ve got, they are still not at a level where they accept responsibility for post commencement funding; purely because of the fact that they were usually in control with turnarounds, if you look at the London approach; and they were basically in a space of workouts.”

#### 5.8.14 Reasons for lack of PCF by distressed lenders

FIN3: “In the US I had far more confidence because of a lot of case precedent, so I knew it was a fairly prescriptive process, knew what the outcome was going to be, it was productive and the process was predictable. Then the bet became am I betting on the right person, with the right management team and the right business. That was the skill then that differentiates you; whereas here there are too many variables.”

*FIN3: "This should be an asset class, it should be of appetite to private equity funds because of its complexity, its difficulty and it requires financial engineering and business skillsets, all the skillsets that you need as a private equity practitioner are applicable here. There is too much opacity and ambiguity in the law to give enough confidence to those practitioners to step in and be active in it."*

*BRP4: "Previously under the London approach it was easy to come in and do a debt equity swop and say listen okay we will give you R30 million but it is on a pref share or a redeemable pref and whenever you want to cash in you can take over the company. Now that is not allowed under Chapter 6 unless it is indicated in the plan. Now my experience is plans that have got debt equity swops and those kinds of things, your normal creditor out there doesn't understand it, it is too high finance for them to grasp on to and they tend to walk away from it. Banks are also not happy with it because they lose further control."*

## APPENDIX 13 – DETAILED RESULTS: RESEARCH PROPOSITION SIX

### 5.9.2 Life cycle or phase of business

*BRP4: “Now in your life cycle that is one of the variables that plays a huge impact is how you can adapt to change and what have you got in your back pocket, up your sleeve to actually cope with the change. Your business life cycle, there is a lot of studies being done to say most businesses fail within three years; now once again should those businesses ever have been in existence.”*

*FIN2: “Yes, very much so. This you would need some type of matrix to actually interpret. You have startup businesses, you have businesses who are not in startup phase but they are probably in infancy or during their teenage years in a sense, and then you have businesses who are established. Now for all three of them on the other side you have the distressed indicators, level of distress and reason...Now in a startup phase if you get into distress it is very unlikely that you are going to raise post commencement finance. Why, probably because the funders that are currently in that particular field or who have invested in the business will not be convinced that someone else would come in and see the success of this business, because there is no track record, there is an industry or a market effect on the client so that might be another issue. But if you then take each one of the three, the startup, the infancy and the mature business you then take different factors into account...as established business in an established industry going through a decline would probably not require post commencement finance but would need maybe some distress funding from the IDC coffers.*

*FIN6: “Ordinarily the business develops in cycles, I am sure you are aware of those stages when it starts off and then gets into the growth stage, then it is fully grown and it starts to decline - it doesn't mean that the business cannot go into distress at any of the stages it just depends on how it is actually managed. But essentially maybe where it becomes a major problem, look on the growth stage ordinarily a business could go into distress because of overtrading or overstocking, where you have lack of cash flow because you are on overdrive and you are holding too much product. Then when it is at the top there when you have got a huge market it will be failure probably to manage your margins; so you might be selling lots of things but you are not making money so it could affect. Then on this side you might actually be priced correctly but you are losing market, so there is a lack of demand for your product and though you had tried to work out the model correctly in terms of margins but the business is just going down. So obviously the nature of the intervention at each stage would actually vary.”*

### 5.9.3 When is a business financially distressed

*BRP1: “Stress is when things are starting to go down, funds are not trading as well as it was before, there is a gap in the product, management or something like that. So it is getting stress and it is also having an effect...but it is not critical. Then once it is in stress you need to try and fix it. Then it gets into distress and they use the word distress in the act, but now you have distress which is I can't pay out my employees, you have got no cash flow.”*

### 5.9.5 When to file

*FIN7: “If you are terminally ill to try and save somebody who is terminally ill is not going to happen, and that is how the businesses are as well. If you can see a business already there business rescue or anything is not going to help it, it is just going to go, it is just when.”*

*FIN8: “The longer you prolong that the worse it gets because you are in this negative spiral. People leave, they get fed up, creditors stop giving you money and your whole business model can change. Your customers get reluctant, even the people you are selling to say well are you going to be able to deliver, where is my stock, you are unreliable now, that's what happens and this whole trust/confidence thing happens on both sides - inside the business, outside customers space.”*

*FIN3: “The issue is poor management don't recognize the signs in the future. Also again back to the US as an example, because people have faith in the process they know what is going to happen when you file Chapter 11, they are inclined to do it quicker with more certainty and decisiveness. [CEO of Company X] didn't really know what business rescue was about, he didn't really know what was going to happen, it was too much of a taint so he put it off and he put it off and put it off and put it off until it was too late. So inexperienced managers are the problem in the timing of it, is the first hand.”*

*BRP7: “Ideally you should be thinking about it when it is 8:15pm, 10:30pm it is already getting late and at 11:59 it is kind of over and you know that at midnight you are going to turn into a pumpkin. So you come here and it is just way too late, it is too late.”*