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A pre-assessment checklist to filing for business rescue in South Africa

Vincent Prior
13417402

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

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ABSTRACT

Business rescue is still in its infancy stage in South Africa, with the introduction of Chapter 6 of the Companies Act 71 in 2008 that took effect in mid-2011. To date the success rate has been dismal and value has been eroded as many companies opt to file for business rescue, but shouldn't.

The objective of this research is to determine glaring attributes that would require extensive consideration before filing for business rescue. These facets should be considered in the pre-assessment stage and should be given the due respect to ensure the organisation has a fighting chance at survival.

Business rescue is becoming a tarnished industry within South Africa as a few business rescue practitioners are enriching themselves at the expense of the unexperienced creditors to this new piece of legislation that is designed to help facilitate a turnaround, whilst under the protection of the legal system. This in turn, will help to preserve, not only ailing businesses and their communal value, but the mere jobs of each individual within these distressed ventures.

South Africa has struggled from a growth perspective for the past few years and with the help of legislation, and a thorough pre-assessment, ailing and distressed businesses may be saved.

KEYWORDS

Business rescue, business rescue practitioners, pre-assessment, turnaround, financially distressed, Chapter 6.

DECLARATION

I declare that this research work is my own work. It is submitted in partial fulfilment of the requirements for the degree of Masters 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: Vincent Prior

Signature: ______________

Date: 10 November 2014

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DEDICATION

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I love you with all my heart.

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CHAPTER 1

1.1 Research title

A pre-assessment checklist to filing for business rescue in South Africa.

“When fate throws a dagger at you, there are only two ways to catch it – either by the blade or by the handle.” – Chinese Proverb.

1.2 Problem definition

1.2.1 Introduction

The World Bank is on record stating that “the rescue of a business saves 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).

Terblanche (2013) reported that organisations that have concluded their business rescue operations in South Africa saw a successful turnaround rate of between 12 and 15% in 2012. Terblanche mentioned that although there was a 24.5% reduction in voluntary liquidations in the same year, this could be interpreted as businesses attempting to reap the benefits from Chapter 6 of the Companies Act 71 of 2008, which came into effect in May 2011. He further suggested that this may be a result of organisations opting for business rescue, instead of the obvious demise associated with liquidation. If stakeholders could identify early enough, and with some degree of accuracy, distressed entities that have the potential to be rescued, this could assist creditors and lenders to decide whether or not to continue offering credit or to petition for liquidation (Smith & Graves, 2003). Argenti (1976) makes use of a quotation by Altman, who is one of the most revered academic writers in the field of corporate failure, that it is of vital importance to try to predict impending failure as far in advance as possible to be able to do something about it.

When comparing statistics globally, Chapter 11 bankruptcy in the United States has seen failure rates well over 70% (Kennedy, 2012; Volkov, 2010). In Canada, the commencement level is relatively high, where 75% of business rescue plans are accepted and commence with proceedings. This is mainly due to the fact that only larger organisations initiate business rescue in Canada (van Rooyen, 2012). Of these, a success rate of 80% has been recorded, with a long-term success rate of 60% (van Rooyen, 2012). This is an erratic global statistic, as different countries apply their equivalent business rescue legislation differently. However, given the novelty of the Act in South Africa and its unfamiliarity for numerous stakeholders, the South African success rate may begin to improve, given time.

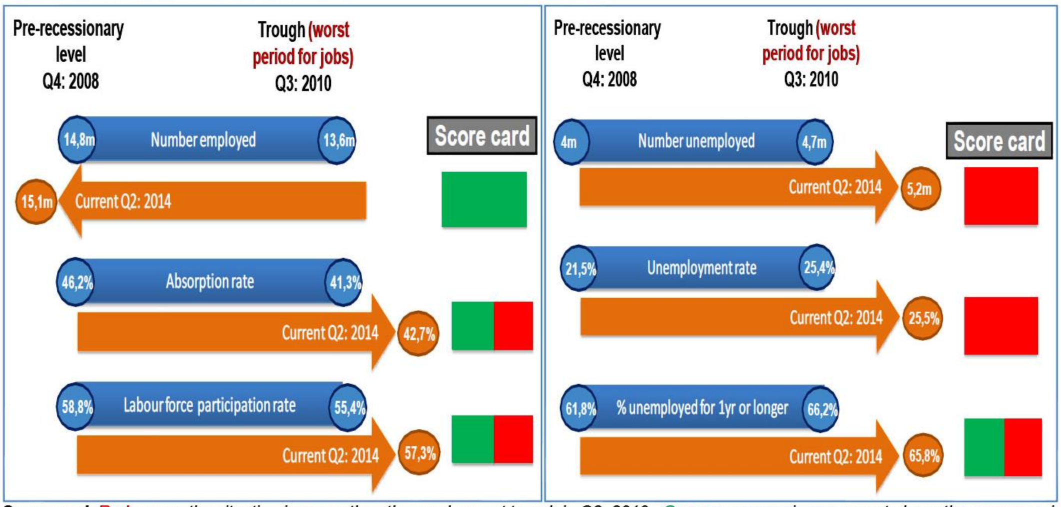
In a survey conducted by Deloitte (2014), more than 30 restructuring professionals in South Africa from a wide variety of disciplines were interviewed to gain a deeper understanding into their expectations for the restructuring outlook. It was found that 41% of the professionals that responded had attained a business rescue success rate of less than 25%. Deloitte (2014) go on to define a successful business rescue as a case that renders better returns for creditors, and that the business continues as a going concern.

1.2.2 South African context

The South African economy saw average growth rates in the region of 5% in the years 2004 to 2007 (Statssa, 2014). As a significant effect of the global financial meltdown in the period 2008 to 2012, the South African economy has slowed down drastically and experienced an average growth rate slightly above 2% (Statssa, 2014).

Coupled with the deceleration of the South African economy has been the increase in the unemployment rate. According to Statistics South Africa (2014), it is estimated that 25.5% of the labour force is unemployed. As seen in the table below, there has been a significant increase in the number of unemployed individuals since 2004 (Statssa, 2014).

Figure 1: Labour market dashboard



Score card: *Red means the situation is worse than the employment trough in Q3: 2010. Green means an improvement above the pre-recession level. Green/Red means improvement above worst level but not back to pre-recession level.*

Source: Statssa (2014). Quarterly Labour Force Survey: Quarter 2 (April to June), 2014 Press Statement

The above figure portraits a grim image of the unemployment levels in South Africa. When businesses fail, unemployment levels will only but increase. If business rescue, could in any way, assist financially distressed organisations to continue trading, it would assist the employment dilemma that South Africa faces.

In South Africa, according to the Companies Act 71 of 2008 (Chapter 6), it is a prerequisite that a company must be in financial distress - but still economically viable - before the organisation may initiate business rescue proceedings. The author will attempt to highlight certain factors throughout this research to assist stakeholders in ensuring that companies that file for business rescue are indeed still economically viable, and not past the point of no-return regarding their sustainability.

1.3 Overview of Chapter 6 of the Companies Act no. 71 of 2008

The Companies Act 71 of 2008, Chapter 6, section 128 (f), defines financial distress as follows: (Republic of South Africa, 2008, p. 230)

(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 ensuing six months"; or

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

According to Werksmans Attorneys (2011), "Chapter 6 of the South African Companies Act addresses business rescue, and has replaced the previous judicial management tool of the old Companies Act No. 61of 1973". The term 'business rescue' refers to actions or activities to assist the turnaround of a business that is financially distressed, by allowing for provisional supervision of the organisation and the management of its activities, trade and property, as well as a provisional moratorium on the rights of claimants against the organisation or in respect of property in its possession (Werksmans Attorneys, 2011). "The business rescue process climaxes in the development and implementation of a plan to rescue the business by restructuring its affairs, business, assets, debt, other liabilities and equity" (Werksmans Attorneys, 2011). "Business rescue's main objective is to maximise the likelihood of the entity continuing to exist on a solvent basis". "Should this not be possible, the execution of a business rescue plan should result in an improved return for the business's creditors or shareholders that would arise from the immediate liquidation of the company" (Werksmans Attorneys, 2011).

"In terms of the Act, business rescue proceedings are mainly self-administered by the company under the autonomous supervision of a hired business rescue practitioner (BRP)". "The entire process is also subject to court intervention applied for by any affected person (i.e. trade union, creditor, employee or shareholder)" (Werksmans Attorneys, 2011). "The interests of these stakeholders are acknowledged, and their participation in the development and approval of a business rescue plan is allowed for" (Werksmans Attorneys, 2011).

1.4 Research motivation

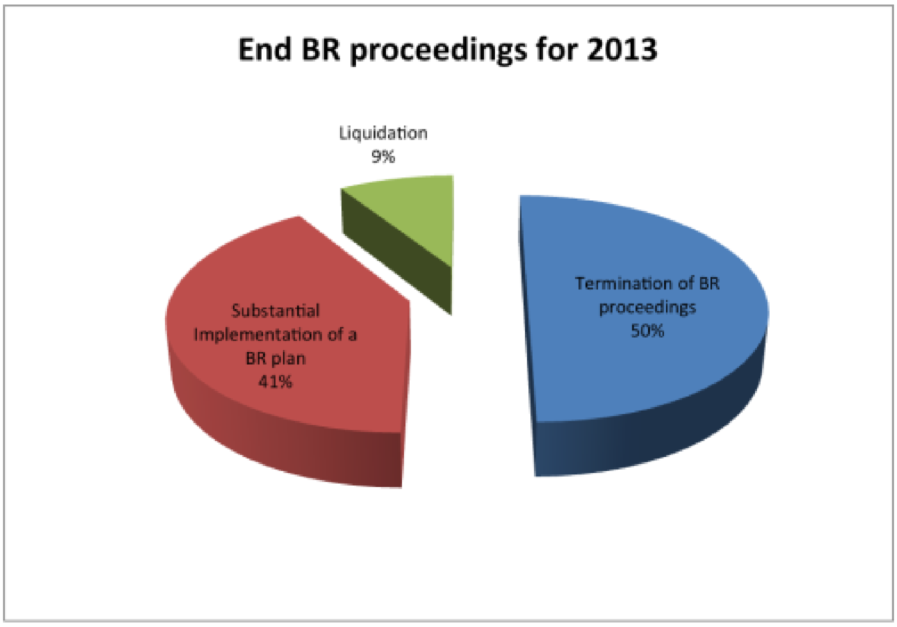
According to Pretorius (2014), there is no broadly-accepted tool, process or system currently being used in the turnaround industry that can help practitioners to determine their success in advance. Business recue is not for the fainthearted and the author of this research attempts to highlight why, as well as to understand the factors that lead to financial distress. By examining the similarities between 'rescued' and 'failed' companies, as well as through interviews with industry experts, we may understand what the potential outcome may be for companies prior to their entering business rescue, and to assess whether they are a worthy potential candidate for business rescue, or if the organisation should file for liquidation.

According to Pretorius & Holtzhauzen (2013), extensive theory exists in the literature on company failures and turnarounds. However, a major void still exists with regard to the practical verifiers of the causes and signals of a company in a downward spiral, as many business rescue practitioners decline to report conclusively what they experience in the marketplace; they evidently view this information as their own 'intellectual property'.

The rationale behind this research is pertinent to the present South African context, where an unemployment statistic of 25.5% is a daunting number, not only for Government, but for the regular man on the street as well (Statssa, 2014). Further to this, five out of every seven small businesses that start in South Africa will fail within their first year (Kgosana, 2013).

With this frightening statistic in mind, as well as Terblanche's (2014) discussion on the fact that since 1 May 2011, 1 526 companies (the majority of which have been trading for between five and ten years) have initiated business rescue proceedings, and 50% have failed to emerge as a going concern in any form, further highlights the need to address and create a pre-assessment checklist to ensure that society does not incur unnecessary costs and erode the remaining value that is still contained within struggling businesses. If failure is imminent, there should be no need to reduce the potential dividend owed to stakeholders through the costly business rescue proceedings.

Figure 2 – Business Rescue Proceedings for 2013 in South Africa



Source: Terblanche (2014).

The odds are truly stacked against an entrepreneur, in that, should they survive the first year of trading, the next decade will prove to be just as difficult. However, as mentioned earlier, a call for concern is that only between 12 and 15% continue with business or as a going concern, even in a new form, long after the business rescue practitioner has exited (Terblanche, 2013).

1.5 Research problem

This study will attempt to gain a deeper understanding into certain indicators that could assist the relevant stakeholders in their decision to proceed with business rescue or not.

The research will design a 'pre-assessment' checklist to assist business rescue practitioners as well as other stakeholders to anticipate the outcome of the business rescue proceedings, to determine whether or not to commence with business rescue.

1.6 Research scope

The scope contains possible indicators that lead to the failure of business rescue in South Africa. Thus research pertaining to turnaround management and analysis is crucial for this study. This study will address 'harder' facts, such as financial aspects of the presumed distressed organisation that will examine numerous financial ratios to assess the historical and current positions of the business, as well as 'softer' elements such the incentive schemes for senior managers that may determine their behavioural patterns during a restructuring and turnaround process.

1.7 Conclusion

There are a number of stakeholders that are affected in the process of business rescue and perhaps this long, when failed, value-eroding process could be avoided if the potential outcome could be determined beforehand. Using the findings of this research, the outcome may be predicted with a fair amount of certainty.

This research seeks to assist stakeholders in assessing and highlighting certain "vital signs" of companies in the days prior to them filing for business rescue, and to assist the business rescue practitioner and the relevant stakeholders in determining the likelihood of a recovery, and of long-term sustainability. Further to this, Chapter 6 is still relatively new in South Africa, and this research will aid in simplifying certain attributes within companies that are considering business rescue, so as to clarify issues that may be blurred by business rescue practitioners seeking to enrich themselves at the expense of others.

CHAPTER 2

2.1 Theory and literature review

2.1.1 Introduction

According to Terblanche (2013), a TMA meeting (Turnaround Management Association of Southern Africa) was held in early 2013**.** Questions were posed whether business rescue was veering off-course and was perhaps too legally focused and also whether key financial considerations were snubbed in favour of legal considerations.

"The CIPC indicated that a sure-fire solution would be to increase financial analysis prior to the filing for business rescue. There is a far greater role for financial specialists to play in providing an objective and realistic view on the business plan, prior to filing for business rescue." (Terblanche, 2013)

According to Smith and Graves (2005), the act of incorrectly classifying distressed companies as "potential recoveries" instils a self-fulfilling prophecy, where these companies are unable to attract the resources required to recover, and, as a result, society incurs avoidable losses such as legal costs, losses to unsecured creditors, shareholders and employees. As mentioned earlier, if stakeholders could identify (early enough and with some degree of accuracy), distressed entities that have the potential to be rescued, it could assist creditors and lenders to decide whether or not to continue offering credit or to petition for liquidation (Smith & Graves, 2005).

2.2 Organisational decline and financial distress

Pearce and Robbins (1993) and Barker and Mone (1994) interpret organisational decline to be at least two successive years of financial decline by measuring return on investment (ROI) and net margin. According to Pretorius (2009), trying to understand business failure presents a huge theoretical challenge that still fundamentally remains to be met. The main reason for the lack of understanding of the concept is the lack of an adequate definition of failure. In the literature, Pretorius (2009) defines it as "*when an entity unwillingly becomes unable to draw equity funding or new debt to reverse decline; subsequently, the business cannot continue to operate under the existing management"* (Pretorius, 2009). When failure is reached, operating activities cease and judicial proceedings take effect (Pretorius, 2009).

The South African accounting and auditing firm, Deloitte (2013), published an article, with extracts from the Act, clearly defining financial distress:

"The Companies Act defines 'financially distressed', to mean that 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
- Reasonably likely that the company will become insolvent within the immediately ensuing six months."

Financial distress is not well-defined in itself. However, by making use of the following narrow definition,- viz. *a balance sheet test for solvency which omits subordination agreements and other management action* (Werksmans Attorneys, 2011), - you may arrive at a verdict that may not serve the greatest interests of affected parties (shareholders, creditors and employees). These actions may have a detrimental effect on both the company and its stakeholders (Deloitte, 2013). In 1968, Altman became the first individual to classify, model and predict bankruptcy (Altman, 1968). Financial distress was defined by Altman as liquidation, bankruptcy and insolvency of a debtor who defaulted on payments, for the benefit of a creditor (Altman, 1968). In this 1966 research, Altman concluded that the best indicator of bankruptcy was the ratio of cash flow to debt (Altman, 1966). This ratio will be explored a little further in this research paper.

According to Steyn-Bruwer & Hamman (2006), financial distress is defined as a certain point in the organisation's existence when it can no longer continue to trade in its current form.

The researcher has separated the pre-assessment determinants into two groups: External and Internal factors. This is used to assist in attaining a macro- and micro-analysis of the indicators that may be used to assess a company prior to its filing for business rescue.

2.3 External indicators

2.3.1 Business rescue practitioners' reputation

A national survey was conducted by Deloitte (2014), where more than thirty restructuring professionals were interviewed. The population of this sample comprised of Commercial Banks (29%), Business Rescue Practitioners (26%), Lawyers (17%), Development Finance Institutions (11%), Distressed Lender / Private Equity (6%) and other key professionals (11%). In this survey, an overwhelming 79% of respondents believed that business rescue practitioners are not adequately skilled to manage a successful business rescue.

According to an interview conducted with Professor Marius Pretorius by the Business Day (2014), the unwillingness of banks to maintain financial assistance to distressed organisations that are in business rescue, is "not helping the problem." Pretorius (2014) mentions that there are "lots of unscrupulous people" who are stretching the process of business rescue so as to increase their fee-earning period, and this is leading to a breakdown in trust between banks and business rescue practitioners. With this breakdown of trust, and the banks' unhappiness with the practitioners, the banks tend to exercise their power within this process by voting against the proposed business plans of the practitioners, and often their vote counts more than 25% due to their large amounts of credit within the organisation. A practitioner requires a 75% vote of confidence by the creditors in order to approve the business rescue plan.

This highlights the importance of the integrity of the business rescue practitioner and his role in conducting a pre-assessment of the business, so that all (or the majority) of the stakeholders may be clear on the potential outcome should the business enter business rescue.

Pretorius (2014) summarises the position and actions that the banks have adopted, as being largely due to, which practitioner is appointed and what his/her qualifications and track record are with the banks.

2.3.2 The business rescue practitioner's roles and responsibilities

According to CIPC (2014), a business rescue practitioner may be defined as an individual appointed, or two or more individuals appointed jointly, to oversee an entity during business rescue proceedings. The tasks of a business rescue practitioner are outlined as follows:

(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";
(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,
(iv) "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" (CIPC, 2014).

Section 138 of the Companies Act defines the qualifications of the business rescue practitioner:

Accreditation by Commission of legal, accounting or business management profession or has been:

(*a*) Licensed as such by the Commission in terms of subsection;

(1) For the purposes of subsection (2) (*b*) (ii), the CIPC may license any qualified person to practise in terms of this Chapter and may suspend or withdraw any such licence in the prescribed manner.

(*c*) is not subject to an order of probation in terms of section 162 (*d*) would not be disqualified from acting as a director of the company in terms of section 69 (8); *(e)* does not have any other relationship with the company such as would lead a reasonable and informed third party to conclude that the integrity, impartiality or objectivity of that person is compromised by that relationship; and (*f*) is not related to a person who has a relationship contemplated in paragraph (*d*) (CIPC, 2014).

2.4 Internal indicators

2.4.1 Efficiency indicators

Ndofor and Sirmon (2013) argue that the events surrounding the decline of a business should be dealt with under two main headings: Retrenchments and Strategic Actions. *Retrenchments* refer to operating cost and asset reduction; strategic *actions* are those actions undertaken to change or adjust an organisation's domain and how it competes within that domain. Campbell (2012) measured 'profitability' on an efficiency ratio in terms of return on total assets. He found that companies that displayed swift actions through efficiency-orientated strategic moves had a greater tendency to turn around (Campbell, 2012). According to Roode and Leith (2006) total asset turnover, fixed-asset turnover, as well as equity turnover are all measures of efficiency.

Each of the above-mentioned ratios are explained below:

<u>Total asset turnover:</u>

Total asset turnover can be defined as an entity's ability to produce sales given its share in total assets. A ratio of 2 will mean that for every Rand invested in total assets, the business will generate 2 Rands in revenues. Capital-intensive companies will have a lower total asset turnover than non-capital-intensive companies (Roode & Leith, 2006).

$$\frac{\text{Net sales}}{\text{Average total sales}}$$

This ratio assists us to comprehend the relationship that exists between total turnover and the entire asset-base used to generate the revenue (turnover). This is known as an efficiency ratio, and is more specifically referred to as an asset efficiency ratio (Graham & Winfield, 2007). It is important that this ratio cannot stand on its own, and needs to be compared to a previous period (quarter, year, etc); only then will it begin to acquire meaning (Graham & Winfield, 2007).

Assuming that the previous year's total asset turnover was computed and compared to that of the current year, if the ratio (i.e. the answer from the calculation) is less than that of the previous year, it may be concluded that the organisation is using its assets less efficiently than they did in the previous year (Roode & Leith, 2006). It is important to note that this is not necessarily the beginning of the end, as there may be numerous reasons why this ratio has shown a loss in asset efficiency. One such reason may be the economic effect of the current year - and there are many more ratios that need to be considered.

Fixed asset turnover:

Fixed asset turnover is comparable to total asset turnover; with the only difference being that fixed assets are taken into account (Graham & Winfield, 2007).

$$\frac{\text{Net sales}}{\text{Average net fixed assets}}$$

The researcher now turns his attention to determine how efficiently the organisation has been utilising its fixed assets to generate sales. It contrasts to the above-mentioned ratio (total assets turnover) as follows; this ratio measures more specifically how efficiently the organisation has used their fixed assets in particular to generate revenue. The same process as above applies, where one would make use of a previous period (quarter, year, etc.) and divide this by the total fixed assets, to arrive at a ratio (Graham & Winfield, 2007). Should the previous period's number be greater than that of the current period, this again indicates that the organisation is becoming less efficient (Graham & Winfield, 2007). However, this number should be approached with caution, as businesses that are expanding, will tend to see a small decrease in this ratio as their asset value spikes. Equally important is to remember that the increase in assets may have come relatively close to the end of the year, and this would distort the ratio (Graham & Winfield, 2007).

Equity turnover:

According to Roode and Leith (2006), equity turnover is a ratio that measures a business's ability to produce sales given its investment in total equity (preferred stockholders and common shareholders). A ratio of 2 will mean that for every Rand invested in total equity, the entity will generate 2 Rands in revenues.

$$\frac{\text{Net sales}}{\text{Average total equity}}$$

Equity turnover is used to monitor how much revenue (via sales) is generated for each Rand of equity that is in the company. The data that is required to calculate this ratio can be found in the balance sheet and income statement of the organisation. Again, it is important to benchmark this ratio against a previous period so as to ascertain whether or not there has been an increase in efficiency, and the way that equity is used to drive revenues upward (Roode & Leith, 2006). This is a ratio that is often closely monitored by shareholders, as they wish to optimise their investments and know that their equity is assisting the organisation to generate greater revenues (Roode & Leith, 2006).

Inventory turnover (days):

$$\frac{\text{Average inventory x 365}}{\text{Cost of sales}}$$

For many organisations that have a significant amount of inventory, such as retailers and manufacturers, a crucial determinant of success is the rate at which they can sell their inventory (Graham & Winfield, 2007). To calculate this ratio, one would multiply the current period's stock value (the period may be monthly, quarterly or yearly) by the number of days chosen for the period and compare this with the previous period's stock value multiplied by the number of days chosen for the period. In the above-mentioned formula, one-year periods were used; hence the inventory would be multiplied by the number of days in the year (365). This is then divided by the total cost of sales that the organisation experienced for the period (Graham & Winfield, 2007). If the answer is lower for the current period than it was for the previous period, then the organisation is beginning to show signs of increased efficiency (Graham & Winfield, 2007).

These are important aspects to remember for a business that may be in financial distress. Assuming that they should pay their suppliers on a 30-day account but have an inventory turnover of 75 days it would immediately be obvious that this organisation was beginning to experience cash flow problems. This is where it may be important for the business rescue practitioner to sell off 'dead' or 'slow-moving' stock immediately, so as to free up much required cash. According to Denis and Rodgers (2007), companies in the United States of America (USA) that significantly reduced their assets and liabilities while still in Chapter 11 bankruptcy, increased their probability of emerging as a going concern with positive operating margins in the three years after they filed for Chapter 11 bankruptcy.

As mentioned earlier in this research paper, Altman's 1968 conclusion of the importance of the cash flow to debt ratio cannot be ignored (Altman, 1968). This ratio is used to measure the period it would take for a company to repay all its debt if it were to only use its cash flow (Altman, 1968). Although this is not realistic, as there are other overheads that are also required to be paid, it makes for good 'what-if' analysis as a starting point to compare an organisation's performance and results to that of other companies. This ratio can be calculated as follows:

Cash flow to debt ratio:

Roode and Leith (2006) define cash flow as the organisations ability to generate cash, the timing of the cash flow and the certainty with which the cash can be generated, as well as, the organisations utilisation of the cash generated.

$$\frac{\text{Cash flow from operations}}{(\text{Short-term debt}) + (\text{Long-term debt})}$$

Smith and Graves (2005) state that cutbacks and efficiency improvements are important factors for the successful turnaround of a business, as resources become released that may be used elsewhere. If the financial downturn is largely caused by inefficient operations, Smith and Graves (2005) propose that the business should adopt efficiency-oriented reorganisation methods, such as cost cutting. They continue by saying that this plays a pivotal role in winning back stakeholder support and raising external resources to fund critical aspects. Laitinen (2008) summarised in his research that whatever the reason may be for the distress, adopting efficiency-oriented recovery actions, is crucial for any successful turnaround. This further validates the research done by Trahms et al. (2013).

An important element to consider is that under sections 134, 135 and 136 of the Companies Act no. 71 of 2008, which is unique to South Africa, "Employee claims arising during the business rescue proceedings take priority over all post-commencement financing, whether or not secured, and over all precommencement unsecured claims as well as employment contracts. These may not be suspended or cancelled and employees must be kept in place during the proceedings on the same terms and conditions as prior to the proceedings. This is without prejudice to the provisions of the business rescue plan which may provide for retrenchment on the terms allowed by the Labor Relations Act 66 of 1995" (Mindlin, 2013). This is certainly an important characteristic of the South African Companies Act, as senior decision-makers within an organisation find it very difficult to use retrenchment as a means of increasing efficiency within a company.

2.4.2 Internal climate, decision processes and remuneration

McKinley, Latham and Braun (2014) addressed two key aspects (each with opposing views) that arise: the first highlights turnaround through innovation, as well as a downward spiral through innovation, while the second scenario is a downward spiral through rigidity and a turnaround through risk avoidance (rigidity).

What remains constant for these aspects, is their reference to Kahneman and Tversky's (1979) study of prospect theory. This theory proposes that individuals are loss-averse and therefore, should they believe that the situation is a 'loss', these individuals would be driven to attempt to recover from the situation by pursuing recovery through risk-seeking activities. It must be stated that the opposite is applicable: should the individual view the situation as a 'gain', they will become risk-averse.

With the above in mind, McKinley et al. (2014) make use of three key variables, identified by Mone, McKinley and Barker (1998) throughout their research. They focus on: (1) The degree to which power is concentrated in a declining organisation, (2) the degree to which managers believe the downward spiral is attributable to controllable situations, and (3) the degree to which managers feel the decline is caused by a permanent factor. The first two variables point towards the manager's control (or at least, the belief of control), while the third variable highlights a particular level of urgency related to the decline. Mone et al. (1998) state that when power in an organisation is concentrated within top management, it reduces the potential for political coalitions to form within an organisation that may hinder the turnaround process.

Trahms et al. (2013) found in their research of organisational decline and turnaround, that the leadership team can hinder or facilitate a turnaround. Specifically, the turnaround can be brought about if the top management team (TMT) are well-compensated, if the managing director or chief executive officer (CEO) fulfils the necessary criteria (experience, etc.), as well as the composition and vigilance of the Board of Directors (BoD) (Trahms et al., 2013). The career-limiting risk that is linked to a firm's decline is not attractive to high-quality managers and CEOs. To mitigate the potential of them fleeing, compensation should outweigh risk. Trahms et al. (2013) further found that equity-linked compensation results in a stronger alignment and allegiance to the organisation. Campbell (2012) noted that an executive's personal wealth strongly influences their speed in execution of strategies, in Research and Development (R&D), amongst others. Latham and Braun (2009) also found that firms with higher management ownership levels, reduced R&D expenditure, as well as any form of complacency, during a decline and business rescue position. This is crucial when a business is placed under business rescue, as time is not an abundant resource and the business rescue practitioner may delegate his powers to directors or managers to assist in the speedy execution of his designed and approved business rescue plan (Mindlin, 2013).

Terblanche (2013) is on record for stating that a business turnaround process in South Africa typically takes 5.6 months to run its course, further highlighting the fact that swift actions are required, so as to not incur unnecessary additional costs.

Evans, Luo, and Nagarajan (2014) argue that the performance of the company's CEO is crucial to organisations in Chapter 11 bankruptcy to ensure both profitability and survival. It was found that where creditor controls were weak, incumbent managers became ingrained and rigid, due to the lack of properly controlled incentives (Evan, et al. 2014). However, as creditors began to gain more control and bargaining power, they were able to offer more lucrative incentive contracts to CEOs and top management. Accurate incentives to CEOs and top management that reflect the deliveries of their efforts are particularly important in a Chapter 11 bankruptcy environment, where moral hazard is compounded (Evans et al. 2014).

Evans et al. (2014) stated that when an organisation found itself in Chapter 11 bankruptcy, where the CEO's contract featured greater pay-for-performance clauses, the creditor's interests were served in three ways:

a) The incentives lured more skilled managers and CEOs who were aware that their heightened skill levels would lead to them achieving their targets, and compensation would in turn be more lucrative to them. Lesser-skilled CEOs were afraid to accept these 'riskier' contracts (Evans, et al., 2014).

b) When incentives were based primarily on performance, the moral hazard problem was addressed with regard to the CEO's effort, as performance incentives made it worth the CEO's time and effort to work hard and maximise the organisation's value (Evans, et al., 2014).

c) Lastly, where major performance bonuses were included in the CEO's contract, the incentive for the CEO to make use of private data, information and company-specific know-how, to the benefit of the organisation, was a lot more forthcoming (Evans, et al., 2014).

With regard to the composition of the BoD, Trahms et al. (2013) continued the work of Daly (1996) and found that, of the organisations that filed for Chapter 11 bankruptcy in the USA, those with a larger percentage of outsider directors had a 65% greater possibility to recover than firms with majority insiders. This factor can be discarded as a result of sections 138 – 143 of the Business Rescue Act, which states that the practitioner controls the proceedings after an application has been filed and approved, as well as the fact that he controls the operation of the business while the entity is under business rescue (Mindlin, 2013).

Another crucial aspect of management is mismanagement. Argenti (1976) concludes that failure is more often than not due to bad management in the senior echelons of an organisation. He goes on to summarise 'bad management' in the form of six aspects:

1: The chief executive officer is an autocrat. Instead of being a leader, the CEO dominates and intimidates his/her colleagues.

2: The majority of the board members do not participate in the day-to-day affairs; hence they cannot pass valuable comment as top management.

3: Departmental or specialist directors tend to leave key decisions to the general management.

4: The company's chairperson is also the company's chief executive officer.

5: The knowledge and skills of the board are not balanced. For example, there may be too many marketing directors and no engineering skills on the board.

6: The finance function is poorly fulfilled or not at all representative on the board. The depth of management skill in the tier just below the board of directors is not sufficient.

The researcher understands that all businesses operate differently, and that not all failing companies display the six above-mentioned aspects. However, this is often why no person challenges the chief executive officer (who more often than not is the only individual who has an overall view of all the intricacies of the company); when he/she puts a positive slant and a hint of optimism on the horizon, when in fact "the writing has been on the wall" for some time (Argenti, 1976).

2.4.3 Company size

The size of the firm has also been found to portray certain characteristics according to Audia and Greve (2006). Smith and Graves (2005) noted that larger firms are generally better equipped to raise additional funding than smaller firms. This leads one to believe that a more aggressive approach to operating cost reduction as well as the swiftness of strategic execution by vigilant directors may increase the entity's efficiency ratios (Smith & Graves, 2005). This is crucial in a South African business rescue scenario, as post-commencement finance is extremely difficult to raise in the South African environment, where the financiers of this capital are generally ranked third in the pecking order of priority, after employees and the business rescue practitioner have been remunerated, (along with all other rescue effort costs incurred) (Du Preez, 2013). However, larger institutions often intervene when an organisation is deemed 'too big to fail', as has been seen in the automobile industry in the USA, as well as the banking sector in the United Kingdom (UK) and the USA (Smith & Graves, 2005).

Trahms et al. (2013) found that smaller, family-owned businesses had a mixed effect during turnarounds. When there is a strong tie to a family firm, the long-term goal orientation, altruistic motives and internal influences lead to family-owned businesses adopting strategies that have downside risk and little upside gain (Trahms et al., 2013). Owner-managed businesses tend to have numerous family members in key managerial positions that may not necessarily be skilled for the job. Often, 'charismatic' turns to 'autocratic' leadership and, as a business grows, it requires a team effort where roles need to be defined and authority delegated, which can be difficult for the charismatic entrepreneur to do (Harvey, 2011). With McKinley et al. (2014) in mind, the second step of rigidity is seldom an option for smaller businesses, as the majority of the resources are under pressure at any given time, hence turnaround through innovation is the only perceived option for a turnaround.

In a study by Morrison (2007), 91 firms were analysed and monitored throughout their Chapter 11 bankruptcy process. It was found that 81% of the organisations had fewer than 20 employees, and a staggering 96% of these businesses had fewer than 100 employees (Morrison, 2007). In this same study, with regard to capital structure, 75% of these businesses had less than US$1million in assets (Morrison, 2007). Furthermore, 62% of these companies shut down or were forced to exit from Chapter 11 (Morrison, 2007). Quite significantly, 86% of these businesses were managed and owned by either a small group of shareholders or by family members (Morrison, 2007).

2.4.4 Free assets

White (1984, 1989) suggested that the number of "free assets" is a crucial variable in distinguishing between businesses that manage to turnaround and those that are liquidated. Campbell (1996) and Routledge and Gadenne (2000) all agreed that the 'free asset' variable is a significant predictor of business recovery. However, the limitations of the information that can be found in financial statements, often makes it impossible to determine which assets have already been used as collateral for secured lending. Hence they propose the following formula to be used to determine the number of free assets available:

$$\frac{\text{Total tangible assets} - \text{Secured loans}}{\text{Total tangible assets}}$$

Post-commencement finance

Also linked to the number of free assets is the matter of post-commencement finance (PCF) which, according to Mindlin (2013), may be secured by any asset "to the extent unencumbered," and will have preference in the order incurred over all unsecured claims against the company. However, Du Preez (2013) confirmed through her research that the current level of PCF in South Africa is non-existent. She notes that some of the reasons for this may be due to the newness of the Act; often, business rescue proceedings are left too late, or the business's financial position is just too poor to allow for any lending against any free assets (Du Preez, 2013). Pretorius (2012) said that the lack of PCF in South Africa is one of the contributing factors to failing business rescues.

Again, and importantly repeated, according to Denis and Rodgers (2007), companies that significantly reduced their assets and liabilities while still in Chapter 11 bankruptcy, increased their probability to emerge as a going concern with positive operating margins in the three years after they filed for Chapter 11 bankruptcy in the USA.

Another ratio that is certainly worth consideration is the debt ratio. This ratio falls into a category known as 'leverage ratios'. Leverage, which is also known as gearing, refers to a means by which an organisation is able to use borrowed money (debt) to "gear up" or "lever" its profits (Graham & Winfield, 2007). This ratio allows a researcher to evaluate the extent to which an organisation uses debt, and hence, understands the organisation's risk-return profile (Graham & Winfield, 2007). This ratio is outlined below:

Debt ratio:

$$\frac{\text{Total debt}}{\text{Total assets}} \times 100$$

It is important to remember that the accounting equation is: Assets = Equity + Liabilities. This highlights that assets are either financed by equity or by debt. The above-mentioned ratio measures the proportion of assets financed by debt and the proportion financed by equity (Graham & Winfield, 2007). It is crucial to remember that the greater the ratio, the greater the leverage, as well as the greater the risk to the organisation (Graham & Winfield, 2007).

2.4.5 Severity

According to Agarwal and Taffler (2007), in 1968 Altman designed the Z-score model that was created to predict the financial health of companies listed on the London Stock Exchange. The first step in generating this model was to calculate over 80 carefully selected ratios from the financial records of all listed firms that failed between 1968 and 1976, and 46 randomly chosen solvent industrial firms (Agarwal & Taffler, 2007). Then, by making use of, inter alia, stepwise linear discriminant analysis, the Z-score model was created by selecting the best set of ratios which, when grouped together and suitably weighted, distinguished optimally between both sets of samples. When a Z-score model is suitably developed, its component ratios characteristically reflect particular key dimensions of corporate solvency and performance (Altman, 1968). The supremacy of this model, results from the appropriate integration of these pertinent dimensions (Agarwal & Taffler, 2007).

The four major dimensions of the organisation's financial profile that are being measured by the Z-score are: profitability, working capital position, financial risk and liquidity.

<u>Z-Score model:</u>

$z = 3.20 + 12.18_{x1} + 2.50_{x2} - 10.68_{x3} + 0.029_{x4}$

where

x1 = profit before tax/current liabilities

x2 = current assets/total liabilities

x3 = current liabilities/total assets

x4 = no-credit interval

Organisations with a computed z-score < 0 are at risk of failure and those with z-score > 0 are financially solvent.

2.5 Conclusion

To try and understand business failure presents a huge theoretical challenge that still fundamentally remains to be met (Pretorius, 2009). It is hoped that through this research, a pre-assessment checklist to determine if a company should file for business rescue, in the hope of regaining sustainability, will have a large weighting to the above-mentioned factors – viz. efficiency, the internal climate and remuneration, company size and free assets, as well as the severity of the current financial position of the organisation.

CHAPTER 3

3.1 Research proposition 1

A checklist can be created that assesses certain company aspects prior to its filing for business rescue, which will assist the stakeholders to determine the potential outcome.

3.2 Research proposition 2

Free assets are the most important variables in determining the likelihood of a successful business rescue.

3.3 Research proposition 3

Larger companies have a greater propensity to survive business rescue proceedings than smaller companies.

3.4 Research proposition 4

Companies that have highly incentivised top management teams, have a greater tendency to endure business rescue and return to sustainability.

3.5 Research proposition 5

Organisations that have a z-score < 0 have less chance of surviving business rescue and returning to sustainable activities, as the financial crippling is too severe.

CHAPTER 4

4.1 Proposed methodology and design

4.1.1 Introduction

Leedy and Ormrod (2001) explained that when a researcher's purpose is to better understand a complex situation, they usually adopt qualitative research, which results in their work being exploratory. Leedy and Ormrod (2001) further stated that researchers may build up theory by using their findings. Finally, it is proposed that qualitative research is often used for the following purposes: description, interpretation, verification and evaluation (Leedy & Ormrod, 2001).

With the emphasis on exploring an area where little accurate theory exists, as confirmed by Pretorius (2009), this research therefore follows a qualitative method, and aims to build on the lack of theory that currently exists in this area.

4.1.2 Induction and Deduction

Saunders and Lewis (2012) define *induction* as a research approach where one derives theory from data collected, and *deduction* as a research approach where the researcher tests a theoretical proposition. This research is based on existing theories of failed businesses, as well as companies that have managed to turn around from financially distressed situations, and aims to test if these theories may be applied to the South African business rescue context. However, it is anticipated that the data collected will demonstrate that the existing theories do not apply fully, as the South African Companies Act makes provision for employees and the business rescue practitioner to be compensated ahead of critical business rescue aspects seen globally - such as post-commencement financiers given preference to claims.

4.2 Research design

4.2.1 Research approach

The research approach is qualitative and exploratory in nature. Exploratory studies are ideal in seeking to obtain new insights or new demands on a topic that is not well understood by the researcher (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).

According to Saunders and Lewis (2012), the general method used to conduct exploratory research is defined in three steps: 1) searching the academic literature, 2) interviewing experts in the subject, and 3) conducting interviews. Therefore, a qualitative and largely exploratory approach is considered. The need for face-to-face interviews with experts in the business environment is required, as this is a relatively new field in South Africa, given that legislation only took effect in May 2011.

4.2.2 Research process

The research study will be a two-phase qualitative study, where further literature reviews will clearly shape the research propositions.

Phase one will involve an in-depth analysis of existing literature to help build a clearer understanding of the concepts surrounding this study and validate the research topic.

Phase two will involve a series of semi-structured face-to-face interviews with industry experts in order to explore the propositions mentioned in Chapter 3.

4.3 Research instrument

A semi-structured interview will be used to collect data; this means that an interview schedule does exist, but does not have to be followed in the precise order in which it is written (Breakwell, 1995). The researcher felt that this was the most appropriate form of data collection, as semi-structured interviews also allow for flexibility without the risk of omitting something of importance (Breakwell, 1995). This form of interviewing was chosen because the varied professional, educational and personal histories of the sample group will preclude the use of a standardised interview schedule (Bargn & While, 1994). The format will also allow the researcher to develop a closer rapport and sense of trust with the respondents. This might motivate the respondents to continue with the interview, leading to more honest and open responses (Stangor, 2010). Semi-structured interviews will allow the researcher to explore respondents' opinions, clarify interesting and relevant issues, and explore sensitive topics (Bargn & While, 1994).

The interview schedule is constructed to draw on issues identified in the literature, and phrased and structured in order to elicit responses relevant to the areas of interest.

According to Belting (2008, p.2), an expert is defined 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."

When purposive sampling is used, the researcher is required to explain the criteria used to determine the sample, i.e. reasons for the choice of expert (Saunders & Lewis, 2012). The factors that qualify a candidate to be an expert in the field of business rescue, as per Du Preez (2012), are discussed later in the research under the topic 'sampling technique', and are used to determine which potential experts may be interviewed.

4.4 Proposed population and unit of analysis

The unit of analysis for this study will be expert business rescue and turnaround practitioners in the Gauteng region of South Africa. Given that resources may be limited in tracing businesses that failed during business rescue, as well as the potential bias that may be encountered when interviewing business rescue practitioners or Chief Executive Officers (CEO) of these failed companies, this research study will attempt to make use of experts in the field of business rescue within South Africa. According to the records of CIPC (CIPC, 2014, p12), there are currently 201 registered business rescue practitioners operating in South Africa. These experts have been actively involved in the field of business rescue, and are well positioned to comment on the above-mentioned propositions.

4.5 Sampling method and size

4.5.1 Sampling technique

Judgment sampling is a non-probability technique in which an experienced individual selects a sample based on criterion relating to the matter (Saunders & Lewis, 2012). For this research topic, the interview subjects must have prior experience in handling a business rescue process within South Africa. Convenience sampling occurs when the researcher obtains units of people who are conveniently available (Saunders & Lewis, 2012).

According to Saunders and Lewis (2012), qualitative samples tend to be purposive, rather than random, which requires the researcher to use their intuition to determine who would be the best-suited respondents. Convenience purposive sampling combined with judgment sampling will be used.

When purposive sampling is used, the criteria used for selecting the respondents must be explained (Saunders & Lewis, 2012). As mentioned earlier, this research topic will make use of the four key characteristics as laid out by Du Preez (2012).

All respondents must have been involved, directly or indirectly, in a business rescue process after May 2011 and must have worked in a business venture for more than three years in order to fully appreciate the dynamics and witness the interaction during business rescue in South Africa. They must be well-seasoned and generally experienced business people, in order to extract knowledge and wisdom from the industry gurus.

4.5.2 Sampling size

It is anticipated that the sample size will be between 12 and 15 respondents. It is assumed that a level of saturation may be reached if conducting more interviews. According to Guest, Bunce and Johnson (2006), a bench mark of six-to-twelve interviews will be deemed more than sufficient sample size for a qualitative study.

The sample size may be impacted by the availability and interests of the chosen respondents.

4.6 Data collection

The following steps were followed in order to achieve the required results (Leedy & Ormrod, 2001).

- Firstly, expert interviews were conducted.
- The interviews were recorded onto two devises.
- Notes were taken during the interviews to begin to derive themes.
- The recordings were transcribed into electronic format.
- The researcher made use of specific software to assist him in generating codes and themes.
- All codes, themes and data were reviewed a second time to ensure that no potential new themes were missed by the researcher.

Interviews were solicited by the researcher sending personalised emails to the identified interviewees. Here in, the following information was included:

- An undertaking to keep all the findings confidential.
- An attached letter from the Gordon Institute of Business Science to validate the researcher's intention.
- An agreement, that a copy of the final report will be submitted to the interviewee.

During the interviews, the researcher adhered to the following:

- To avoid short answers such as "yes" or "no", the researcher kept all the questions open-ended.
- As mentioned above, the researcher opted to make use of semi-structured questions so as to encourage a health flow of thought patterns from the interviewees.

4.7 Data analysis

According to Merriam (1998), data analysis in qualitative research can be compared to a transformation where the researcher returns with the gathered data, then applies their analytic abilities, and finally arrives at the findings; the process is highly intuitive and it is not always possible to locate the source of an insight, induction or deduction.

The analysis method that the researcher will use for this study will be a blend of constant comparative analysis, narrative analysis and content analysis. As there is no 'correct way' of performing analysis in a qualitative study, these methods can be combined effectively, allowing for the constraint that it must be an iterative process in conjunction with the data collection phase (Merriam, 1998).

Once all the data has been captured, the researcher will transcribe all of it and then re-check the transcripts to ensure there are no errors. This will be done to help familiarise the researcher with the data, as well as laying the foundation for the first stage of the data analysis. The analysis will be guided by a thematic approach, as this will allow the researcher to identify themes in the individual interviews, and then relate them to each other in order to uncover the major themes across all the interviews. The researcher feels that a thematic approach to the analysis would be best as it suits the research questions in the study. Thematic content analysis is viewed as a foundational method for qualitative analysis, and is thus considered a fundamental starting point by the researcher (Braun & Clarke, 2006). This approach to data analysis is also appropriate, as it contains a generic element relevant to other forms of qualitative analysis that would be necessary at a later stage. Thematic content analysis allows a flexible exploration of the data captured, and provides a set of methods that exist independently of theory and epistemology, and could therefore be applied across a range of theoretical and epistemological approaches (Braun & Clarke, 2006).

A theme is an entity that captures something important about the data, and represents some level of patterned response or meaning within the data set (Braun & Clarke, 2006). Importantly, the key of a theme is not necessarily dependent on quantifiable measures, but rather on whether it captures something important in relation to the overall research question/s. (Braun & Clarke, 2006). In order to ensure that the thematic analysis was properly done, the researcher will follow six stages of thematic content analysis suggested by Braun and Clarke (2006), which was later refined by Heald (2014):

Stage 1: Familiarising oneself with the data

In this step, it is of the utmost importance that the researcher immerses him/herself in the data (Heald, 2014). This will be achieved by transcribing the data himself and then re-reading it several times. Should this not be possible, all attempts should be made to read through all the transcripts and familiarise one's self with the date (Heald, 2014).

Stage 2: Generating initial codes

This phase can only begin once the researcher has read and familiarised him/herself with the data as described in step one above, as well as generating an initial list of ideas evolving from the data (Heald, 2014). This is done by creating initial codes from the data before the actual themes can be identified (Heald, 2014). Codes are used to identify a feature of the data that appears interesting to the analyst, and refer to the most basic elements of data which can be assessed in a meaningful way in the area of interest (Heald, 2014). Fundamentally, the researcher will arrange his data into meaningful groups, but should be aware that these groups or codes of data might not be the same as the themes. It is important to generate as many initial codes as possible to lessen the danger of excluding elements that might prove important in the later stages of analysis (Heald, 2014).

Stage 3: Searching for themes

Stage three can commence when all of the data has been initially coded and the researcher has a generated a list of initial codes (Heald, 2014). The researcher will analyse the codes to determine whether they can later be linked to create overarching themes (Heald, 2014). Visual displays of these related ideas and codes may assist the researcher to clarify ideas which are related and those which are not (Heald, 2014).

It is at this point that the researcher should begin to develop ideas around which themes are significant to the research and which are not.

Stage 4: Reviewing themes

Once the researcher has created a set of possible themes, the next stage involves further refining of them (Heald, 2014). At this point, certain themes which are not supported by sufficient data from the interviews will be discarded, or themes that were initially viewed as separate will be collapsed into one another if they are very similar (Heald, 2014).

This stage has two phases. The first involves reviewing the coded data extracts to create a thematic map, while the second involves the same procedure, but in relation to the entire data set. Here the researcher considers the validity of the individual themes in relation to the data set, as well as considering whether the thematic map derived from phase 1 of this process, accurately reflects the meanings evident in the data set as a whole.

Stage 5: Defining and naming themes

Once the researcher has adequately considered the thematic map derived from stage four, he will start on stage five (Heald, 2014). This involves even further definition and refinement of the already determined themes that would be used for later presentation in the analysis, and further refinement of the themes within them (Heald, 2014). This process will reduce each theme to its essence. This stage should be kept as simple as possible to limit the possibility of trying to stretch themes too far, and make them too complex (Heald, 2014). Further detailing may reveal the uniqueness of each theme and the reason for its singularity (Heald, 2014). Each individual theme requires a detailed and separate analysis which allows the researcher to explore where the theme fits in the overall analysis and narrative (Heald, 2014).

Stage 6: Producing the report

In the final stage, the researcher will have a set of fully worked-out themes and so be able to perform the final analysis and write-up of the report (Heald, 2014). The goal will be to tell the story of the results in a way that would convince future readers of the merit and validity of the analysis (Heald, 2014). Of equal importance will be to present the results in a concise, coherent and logical way, while retaining sufficient data to demonstrate the prevalence of each theme (Heald, 2014).

In following the stages prescribed by Heald (2014), the researcher should be able to present a set of comprehensive findings and discussion, which will be presented in Chapter Five.

4.8 Potential research limitations

Key limitations of the proposed research methodology and scope are:

- Exploratory qualitative research, is by its nature preliminary, or designed to explore new ideas, and needs to be followed up with more detailed research (quantitative analysis - descriptive and causal), to provide more dependable results (Saunders & Lewis, 2012).
- Exploratory research is subjective and reflects the perspectives of the researcher; in other words, there may be researcher bias (Saunders & Lewis, 2012).
- According to Terblanche (2013), the majority of business rescue practitioners are practising in Gauteng (54%) followed by the Western Cape (21%). This puts a geographical burden on the researcher; hence all the possible expert interviews will be conducted in Gauteng. This may lead to a bias.
- Schendel, Patton and Riggs (1976) argued that recovery strategies are classified into two areas: efficiency-orientated and entrepreneurial-orientated strategies. The researcher has no means of determining the value that entrepreneurial-orientated strategies will bring to the distressed organisation, or how quickly. Hence this aspect may be a fatal flaw in the research process.
- There is a risk of interviewer bias where the interviewer's own bias may affect the respondent's data, and the interviewer may lead or influence the respondent.
- Given the competitive business rescue environment, business rescue practitioners may not always divulge all their negative experiences, and many may lean more to their positive experiences. This may lead to response bias from the interviewed business rescue practitioners.
- Practitioners may also not wish to part with industry specific knowledge that they deem to be intellectual property.

4.9 Conclusion

The data that was derived from the interviews was analysed according to the techniques that were discussed in this chapter. The initial thought was that the sample size may have been too small, it is noted that the researcher managed to interview four percent of the actively practicing business rescue practitioners in the country (CIPC, 2014, p12). Detailed facts were provided by the interviewees which proved to be of significant value to the researcher.

CHAPTER 5

5.1.1 Introduction

In the previous chapter, the methodology was outlined to highlight how the propositions from Chapter 3 would be explained. This chapter will represent the findings from nine expert interviews that were conducted throughout Gauteng, South Africa. As mentioned before, this region of the country was selected as the researcher was limited in his personal capacity for time as well as the availability of the experts in other regions of the country.

All the findings are summarised for each of the propositions that were presented in Chapter 3. Below a short outline of the samples can be found as well as an outline of how the researcher processed and analysed the data.

5.1.2 Description of sample

Out of the nine interviews were carried out, seven were with BRPs, one with a commercial lawyer that specialises in business rescue in South Africa, and finally a professor at a recognised University in South Africa who has done extensive research in the field of turnarounds and business rescue. All the respondents in the interviews are currently involved in advisory/consulting capacities in the business rescue industry within South Africa. All of the interviews were face-to-face, with each interview duration being roughly one hour long. The table below summarises a few of the statistics.

Description	Quantity
Total number of interviews	9
Total length of all interviews	508 minutes
Average length of interviews	57 minutes
Shortest interview	40.25 minutes
Longest interviews	76 minutes
Average length of transcripts	15.33 pages
Shortest transcript	13 pages
Longest transcript	20 pages

All the respondents, however busy, managed to find time to assist the researcher and were more than willing to participate, with all of the respondents stating that they were excited by the topic, as it is crucially needed in South Africa.

5.2 Data analysis

Working within the frameworks of exploratory and qualitative research, as well as the fact that there are only 201 registered business rescue experts in South Africa, the researcher deems that nine interviews is a sufficient response rate. As this is an extremely new field/industry within South Africa, in order to uncover new insights, the research design method of semi-structured interviews was felt to be the most appropriate for this topic. All the interviews were recorded (upon permission from the respondents) and notes were made throughout the duration of the interview. Unfortunately not all the questions were answered and a few of the questions were perhaps not answered in their entirety. All nine interviews were recorded and transcribed.

A software programme, designed for qualitative data analysis, named Atlas ti version seven, was used to categorise the transcribed documents into logical themes. To further reiterate the research methodology that was outlined in the previous chapter, as well as to maintain a strong level of ethical reporting which also lead to unbiased responses; the identities of the respondents are kept confidential. The allocated numbers/order of the respondents do not relate to the order of the interview list found in Appendix 2.

5.3 Results: Research Proposition One - A checklist can be created that assesses certain company aspects prior to its filing for business rescue, which will assist the stakeholders to determine the potential outcome

5.3.1 Introduction and Overall results

In order to expand on the existing theory on Business Rescue, particularly in South Africa, the researcher asked all the respondents what they are currently doing with regards to pre-assessment of business rescue filing of companies that are wishing to enter into business rescue. This would give the researcher insight into what is currently being done, what is and what is not working. Later on in this chapter, the aspects of this pre-assessment are expanded on.

The table below summarises the key aspects that are being assessed by practitioners, as well as to highlight the frequency of these aspects.

DESCRIPTIVE	# OF RESPONDENTS
Access to Post-Commencement Finance (“PCF”).	9
External environment that the organisation is participating in.	9
Accurate and up to date financial statements.	7
“Gut feel”.	7
Overview of who the major creditors are as well as the availability of free assets.	7
Is there still a product?	7
Skill levels of the board/senior management.	6
Can this organisation afford the “BRP”?	6

As can be seen from the table above, there are many common aspects that are honed in on by practitioners when they conduct a pre-assessment on a business. Six elements were mentioned by 77% or more of the respondents as being critical to their checklist before accepting an appointment. A further two elements were mentioned by 66% of the respondents as being influential in helping them determine the viability of an appointment or not. The remainder of this chapter will elaborate on the above mentioned aspects and the views of the experts.

5.3.2 Access to Post-Commencement Finance ("PCF")

It should be noted that 100% of the respondents are on record for stating that if there is no probability of accessing PCF, they will not accept the appointment as the business rescue practitioner. The respondents explained that between 90 and 100% of rescues required PCF in order to execute on a business rescue plan.

BRP3: *"No PCF, no rescue!"*

Researcher: *"What percentage of success do you guys attribute to PCF?"*

BRP4: *"That would be the majority, I mean, because if a company is going into business rescue, generally they don't have funds and they need probably a couple of months breathing space to be able to restructure and cut the cost; without any sort of funding you are going to get nowhere and especially if you are going to restructure, you are generally going to cut the number of staff, and if you have to pay out retrenchments, that initial cash outlay is quite large, obviously you will see the savings down the line but you are going to fail without the PCF."*

BRP6: *"You know don't take an appointment unless you know there is going to be funding during business rescue."*

All the respondents mentioned that you may determine that this company still has a product with high demand and that the internal operations are still in a great position, however, due to some cause, it is now in financial distress. If you cannot secure post commencement finance, then no matter how great the practitioner and his/her team is, a turnaround will not be possible.

5.3.3 External environment that the organisation is participating in

The external environment was also an aspect that 100% of the respondents agreed upon was non-negotiable, and that it is vital that the prospective business rescue practitioner must familiarise him/herself with the environment that the distressed organisation is operating in. The practitioner need not be an expert in the industry, but it is crucial that the practitioner have a basic understanding of the industry and then they must have an industry expert accompany them to give further advice regarding the industry that this distressed organisation is operating in. This is part of the pre-assessment to determine if the organisation is still viable in the market, given its current product offering, etc. It will also help the practitioner understand if this organisation is deemed “too large to fail” and that it will be “missed” in the market if it was liquidated or if it has been trailing competitors for some time.

BRP1: *“I am big on context. Every single case is unique and it is because of the unique context.”*

BRP2: *“If you look at the environment in which they compete that is also very crucial to look at it. It is good to say you have a product but your product must still be in a competitive environment that you are offering. External – absolutely.”*

5.3.4 Accurate and up to date financial statements

This facet of the pre-assessment checklist had numerous aspects to it that were mentioned by the interviewees and it went in conjunction with various other aspects. For example, where there were no management accounts, or the latest audited financial statements were produced at least two years ago. This raises the question as to how would it be possible to raise funds from creditors/lenders if no person is relatively sure as to what the actual health of the company's finances are? The fact that these statements and records are late or non-existent, further highlights the point that there has been an extended period where the organisation has perhaps not had the funds to acquire the services of auditors to do an external audit. It also brings the management of the organisation into the spot-light as follows: Does the organisation have a competent financial manager who can generate management statements at the very least? How could the CEO possibly be making decisions, if he/she is not relatively certain as to the financial position of the organisation?

Coupled with this, were the responses relating to inaccurate financial statements. This, misalignment with the truth, was mentioned by the practitioners as not always accidental or unskilled bookkeeping, but rather accounting practises that bordered on "misrepresentation" or applying "creative accounting".

BRP8: *"But I think the reality is that if they are months behind on their management accounts, it is not a great sign. If they have got no three month cash flow – we are not talking five year, we are talking three month cash flow – that is not a great sign. If their last set of audited financials were two years ago and they were qualified, that is not a great sign."*

BRP7: *"I can tell you now if there is creative accounting and it comes out later it will have a negative outcome without a shadow of a doubt. You lie you lose."*

BRP6: *"If I want to go and understand the composition of their balance sheet and you will typically find some fancy footwork there. But it is not necessarily the finance guy doing it; he is probably following other people's instructions. Reasons that it was in distress you don't have a sufficiently strong finance guy running the place. And… if the finance guy is not strong enough to stand up to the CEO, the CEO normally just does what he wants until it's too late."*

5.3.5 "Gut feel"

This was an observation that was encountered in nearly all the interviews. Although it will be discussed later in the findings pertaining to proposition 5, this must be mentioned as critical to the pre-assessment. This is most certainly related to the experience that practitioners develop after numerous years in the turnaround industry. Everything appears to be in order, but your "gut feeling" is that something is wrong, then you need to know when to listen to it and when to ignore it. This "feeling" was mentioned at varying intervals during the interviews. Occasionally it would surface around the discussions of management skill levels or other times it would rear its head during a topic relating to financial severity analysis. It just appeared and it seemed to be a sixth sense that these industry experts have acquired.

BRP6: *"You know sometimes you are going to have to take a leap of faith and if you think you can get it then go and do it."*

5.3.6 Is there still a product?

One of the non-negotiable aspects for any pre-assessment relates to whether the organisation is in a position of financial distress and does it have a product offering that will be able to generate a sustainable revenue stream in the coming months or is it as BRP3 put it: *"My biggest nightmare is to walk into the proverbial typewriter company"* and it is a company that does not have any foundation left to trade on as its product offering is now redundant? Many of the practitioners spent a lot of time highlighting this point to the researcher. There must still be a viable product offering with sufficient margin that is able to be produced profitably, and supplied into the market place with a positive contribution to overheads.

This aspect is required by the Act as well, in that the organisation must still be viable, but only in a position of financial distress and that with the assistance of the practitioner and his/her business plan will be able to emerge from the position of financial distress.

BRP1: *"I have to establish whether there is demand. That is the core thing. If there is no demand… we've seen it, a guy has a big contract, after the contract there is no demand. Whatever you do or how good you do the business, there is no demand for your product."*

BRP3: *"Level one is where is the value of the business? The first question is, is there loot? The second question is where is the value in the business? Can I understand this business' value proposition? Can I understand it?"*

5.3.7 Skill levels of the board/senior management

This aspect is explored in a lot more depth later in this chapter; however, in response to the proposition, the skill levels of the senior management team are vital to the successful rescue of a business. Mixed views were recorded regarding the management team and their immediate role as the organisation enters into business rescue, and whether or not you should retrench "dead wood." With this said, there was a near unanimous response to the fact that the BRPs cannot do all the work on their own. Respondents mentioned that, particularly in the case of smaller businesses, the appointed practitioner will do everything, including; making the coffee and sweeping the floor. It is vital that the management team be "onboard" for this process as well as have the necessary skills to assist the practitioner to execute on his plan.

BRP2: *"My initial meeting with the board you pick up the negative guys who are the non-performers and you are also picking up on who the heroes are, those are the guys who are optimistic, have a lot of "oomph" and they want to go somewhere. In that meeting, that first initial meeting, you already pick up who the guys are that you can walk the walk with. If one of those guys are negative usually that rot goes down into that section. In your pre-assessment obviously I will look at the composition of the board. You can go a long way with one positive guy if you take away four negative people."*

BRP3: *"The third level is let's have a look at the management of the company.*

What does this management look like? I know that the team that managed it into trouble is never the team that can manage it out of trouble. In fact that is the golden rule. I've found one exception in South Africa and it was a real outlier. Now I have to look at who in the management team are the "can do" and who in the management team are the "can't do" or won't do."

5.3.8 Can this organisation afford the business rescue practitioner?

This is a characteristic that is not only linked to how much cash is still available in the business (or the amount of PCF that is guaranteed in the immediate future) but also to the size of the organisation. Organisational size will be discussed later in this chapter. Many business rescue practitioners prefer to work in teams as opposed to working on their own, as this gives them a "double/triple check" when carrying out certain actions. According to BRP5: *"One of the things that we do in a business rescue is we always involve one of our preferred lawyers up front from the beginning. We've got a couple of selected lawyers that we work with who are particularly knowledgeable legal wise, and we work with them out of preference."* This comes with added costs as well. Occasionally the practitioner needs to bring in a lawyer to ensure that he (the practitioner) is acting within the law, a labour relations lawyer if there are any retrenchments, a forensic accounting firm to verify the financial statements. All of these add-on professionals add additional costs that the already financially distressed organisation needs to pay for, as well as the day-to-day overheads that need to be paid. So business rescue is a costly affair and if there is insufficient "fuel in the tank" to cover only the practitioner's bill, then very few of the experienced practitioners will accept the appointment.

BRP5: *"As a rule of thumb I think a business rescue costs between R200 000 and R500 000 a month on average."*

BRP7: *"It is an expensive process. It is a very expensive process and even if you charge at a medium to small rate as the Act prescribes, it is an expensive process. As part of our assessment, I assume that I will be charging "X" a month* *based on what we know is the time we are going to spend. Remember whether it is a large furniture retail chain or a fish and chip shop, the actual time you spend working on it might be exactly the same. Charging the… I can tell you now if (anonymous) charges R400 000 for a month for his business rescue fees, I am just using a number, at (anonymous) nobody will sneeze at it."*

5.4 Conclusion

In the words of BRP1: *"It is so contextual and it depends."* Every business rescue case is different. This section of the chapter aimed to highlight certain glaring aspects that are being utilised in conducting a business rescue pre-assessment by industry experts, and where they place emphasis exploring and analysing before accepting or declining appointment as the practitioner. All the elements mentioned above are linked to more than one pre-assessment topic as well as to propositions two through five. A pre-assessment is not just vital prior to a business rescue practitioner accepting or declining an appointment, it should become mandatory as it will help to determine and verify many different aspects of the organisation, and determine if the business is rescuable, or if it should file for liquidation and preserve any value that may still be retained within the organisation.

It can also be said that this proposition is supported by existing literature.

5.5 Results: Research Proposition Two - Free assets are the most important variable in determining the likelihood of a successful business rescue

5.5.1 Introduction and Overall results

BRP6: *"… if you don't have that access to cash you know, if the business is really up against the wall, then I think then that the chances of the success of the business rescue without PCF is slim..."*

Throughout all the interviews, the respondents highlighted that Post-Commencement Finance ("PCF") in South Africa is almost non-existent.

BRP6: "*During business rescue you need the ability to have access to cash. So if you can't use the cash flow cycle of the business – you know the collection of debtors and the likes, you know then you are going to need extra funding. And that's where the PCF kicks in. If you can use the stock that you've got – sell that, either cash or debtor, and then you can use the debtor then use that to buy more stock."*

One of the mechanisms that many of the interviewees made use of, was to approach the commercial banks that already had a significant amount of exposure within the distressed companies, and propose the BRP's envisioned business plan to them that would rescue the organisation. This would put the commercial banks at a cross roads between deciding on whether to request liquidation or to increase their exposure to potentially increase their dividend.

BRP6: *"But you need to go to them with some sort of certainty that this plan is going to work and that they will get their money back – and then the banks will lend."*

BRP5: "*It's about making sense of this complex situation and being able to sit with the providers of finance and put to them a picture that shows them that they will be better off by supporting the going forward plan should they not support it. That's the bottom line, and the mechanism or how you come about that, could be* *completely different from case to case, but it would be a combination of business rescue costs, finance costs and about helping people understand where they rank and making it clear and helping them get clarity on how secure are their numbers."*

In all the interviews, the experts mentioned that their services were requested at a very late stage, often too late, and that an" injection of cash" is almost always immediately required.

BRP5: *"Nine times out of ten it's left too late. We believe the signs of distress are there for anywhere from twelve to twenty four months prior to business rescue. We observe that management is in denial, they are operating on a strategy of hope over experience."*

It was noted by all of the respondents that almost all the assets are encumbered and that they cannot be used as collateral to raise "PCF". BRP1 mentions that organisations are too heavily geared and that they are relying on too many orders that are still in the pipe-line to realise, just so that they can repay creditors on over-leveraged assets. BRP1: *"Factoring – if you find factoring at the point of rescue it shows you everything else has been exploited and now we do factoring."*

BRP7: *"The difficulty with PCF is very seldom do you have unencumbered assets. A company that is financially distressed is not going to have unencumbered assets. It has already gone and borrowed to the hilt on its assets."*

BRP9: *"By the time the company gets to its financially distressed position you will find that most of it has been encumbered by means of material bonds, property may have been bonded to the bank, you might find because of a cash flow issue, they have got second bonds registered, etc."*

BRP3 stated that *"you have to go and find out what it is you can do and discuss* *it with your potential PCF provider to see what kind of security you can give them. I had… in all cases I had no security, nothing".*

As mentioned in the previous section of this chapter, during your pre-assessment, it is vital that the practitioner ensures that there will be funding during the business rescue. Given the murky ranking for post-commencement funders and whether they will have a claim on any remaining dividend, collateral is a sure way to give the funder a sense of ease when contributing the much needed "cash injection".

5.5.2 Conclusion

Free assets allow the business rescue practitioner the option of offering up collateral to funders in order to secure the much needed in-flow of money, and it gives the additional credit supplier the peace of mind that he still has a claim and that he will not need to forego his capital contribution to a "whim" that the practitioner has.

BRP4: *"Ja, I mean that definitely helps and makes it a lot easier to raise the fund."*

BRP8: *"No security, and no business plan, and a company that is distressed. Now who is going to give you money?"*

A cautionary point to highlight is to ensure that the assets that are on the balance sheet are indeed still in the business. The probability of "redundant" assets still being on the balance sheet is significant, as it was mentioned previously that record keeping is often non-existent. Further to this, there may be a complete misrepresentation of the assets and it is the period during the pre-assessment that must be used to ensure that there are, honestly, still free assets available in the organisation.

Free assets will most certainly assist the practitioner and give him/her the much needed “PCF” so as to be able to action out their plan. The practitioners all agree, no “PCF”, no rescue. Free assets make it a significantly amount easier for the practitioner to raise these funds.

This proposition is categorically supported by existing literature.

5.6 Results: Research Proposition Three - Larger companies have a greater propensity to survive business rescue proceedings than smaller companies

5.6.1 Introduction and Overall results

With regard to the size of the businesses that practitioners prefer to handle, this was an element that the experts did not hesitate to voice their preference and to elaborate why. Below is a table that illustrates the preferences of the interviewees.

Preferred Organisational Size	**# of Respondents**
Small Businesses only	0
Small & Medium Businesses	0
Medium Businesses only	0
Medium & Large Businesses	4
Large Businesses only	5

From this table, it is clear to see that the respondents preferred to accept appointment to rescue a business that was deemed to be medium and/or large. The manner in which the practitioners determined if their previous clients were small, medium or large was left up to them to interpret and to differentiate. Three of the respondents allocated an annual revenue total of R100 million as their bottom line to accept an appointment and that anything less per year was deemed to be too small to rescue.

Although the researcher understands that the individuals that he interviewed were of the most experienced in this field, within South Africa, and that they are intentionally positioning themselves to participate in the "premium" market, there were however two main reasons for their selection: 1: Levels of management and corporate governance as well as 2: High cost of business rescue.

5.6.2 Levels of management and corporate governance

Many of the responses related to the competence of the management team as well as the existing governing structures that are in place within the organisations.

It was felt that smaller businesses think that once the practitioner is appointed, the entire management team could sit and not have to worry any further. They felt that this individual (BRP), would be parachuted into the organisation and that he would be able to do everything. This is not the case and the day to day running of the business is still required to ensure that it operates at some level of respectability.

BRP3 made reference to a meat processing company and stated *"I cannot be everything to every business. For instance, the meat company, I need to make sure that I have got somebody in my team that knows everything there is to know about meat. Sometimes the owner/manager is the last person you want so I might have to bring somebody in."*

Very often, the smaller companies still have the owner/founder mentality and they have not been able to "change gears" and let more experienced individuals take charge and hence, there is a void in the level of management skill within the organisation. This is very often the case as the business has outgrown the founder, who started in their garage and was able to sell their product or service at a good margin. Adding to this, when it is a small business, the business and the individual cannot be separated and it becomes incredibly difficult for the practitioner to deliver on certain aspects as the owner will say things like "this is how I've always done it!"

BRP7: *"One-man operations or a singular persona – in other words the business is his alter-ego. It is him. He doesn't differentiate. I am saying him because it is normally a male. He doesn't divorce the business from his own identity. It is a big no-no. I won't do that ever again. I have made that mistake too many times."*

5.6.3 High cost of business rescue

The researcher will highlight some of the costs that were divulged by a few of the practitioners. These exorbitant costs were well justified when the interviewees highlighted the size of the business rescue teams that are involved in a typical rescue. Although there is one practitioner appointed (a few enjoyed accepting a joint appointment), the practitioner must be accompanied by varying industry experts and professionals so as to increase his/her chance of success and to also protect themselves from potentially aggrieved stakeholders.

A practical example was provided by BRP7 who stated the following: *"I ask you what is your annual turnover? R12 million. It sounds like a lot of money. It is a million rand a month. Your turnover is a million rand a month. The first month that I am going to work I am going to charge you north of R150,000 and you can't afford that. You can't afford that and that is the reality as well. I say, I don't think you should be in business rescue but maybe Joe will do it for you."* This amount was again verified by BRP1 who explained *"The rescue practitioner takes between R120 000 and R180 000 a month out of the company. They just couldn't afford it."*

BRP3, who only handles larger companies and according to him "*the more complex, the better*" mentioned during his interview that *"As a rule of thumb I think a business rescue costs between R200 000 and R500 000 a month on average."*

Unfortunately, the grim reality for smaller businesses that are facing financial distress, and wish to enter into business rescue, was dampened even further by the response received from BRP5: *"Some small businesses just can't carry business rescue, it's too small and business rescue is a waste of time, they must go straight to liquidation. We tend to turn those down, but we do propose how they're going to fund the business rescue if you don't have loot to pay wages on Friday".*

5.7 Conclusion

Business rescue practitioners that are well equipped with numerous years of experience, as well as the backing of additional skilled professionals, are just too costly for smaller organisations to afford and they are currently left with almost zero probability of being accepted by a practitioner similar to those that were interviewed by the researcher. Practitioners want to enter into a distressed organisation where they can still delegate work to a competent senior management team as well as be able to reap the benefits of their intellectual property when they successfully rescue an organisation.

This proposition, in the context of the interviewees, is supported by existing literature.

5.8 Results: Research Proposition Four - Companies that have highly incentivised top management teams have a greater tendency to endure business rescue and return to sustainability

5.8.1 Introduction and Overall results

This research question also generated a very confident and informed response from the interviewees, except that it was 100% in contrast to the proposition. All nine the experts responded by saying that they have not noticed this in any of their rescues to date. Further to this, this is an element that many of the practitioners said they had very little time to even consider. BRP5: *"I can't say I've noticed or form a causal link, no. I think that, I don't have a strong opinion on it, for us there is a link between cooperation and success."*

BRP6 as well as BRP8 validated this aspect in their response as well: *"Yes, it's a bit strange, with all of those that I have dealt with in the past, other than the one I am dealing with now, all the salaries, the director's salaries, well I haven't seen any bonuses, but the salaries have been all up to date." "You don't see people cutting their salaries, so that is a common thing."*

Two of the respondents mentioned that they did make recommendations to the board of directors once they had concluded their business rescue, however, none of them had returned to determine if it was implemented or not.

One of the business rescue practitioners raised a particularly interesting point. The researcher believes that BRP3 summarised it well, *"I freeze all further increments. There are no bonuses payable. No directors' fees are payable. That all stops! I try not to cut the salaries because what happens is an individual that is already in distress at work and under huge pressure, you cut their salary and you're putting them under stress at home as well. The ordinary man in the street can't handle that. It is very difficult."*

The second part to the above response was a complete outlier with regards to the rest of the interviewees as all the professionals understood that the costs lay within the labour structures and strong descriptive words were generally used regarding labour.

BRP7: *"I may be lynched for this but it is one of the Achilles heels of restructuring is the fact that you cannot cull. I use the word cull because I truly believe that in some instances the survival of a business is dependent on your ability to cull and you can't."*

Further to this aspect of salary and bonus pay outs, BRP4 summarised particularly well how senior managers conduct themselves: *"Cut their salaries. No. And that is one of the things that annoys me most is even when you are in business rescue they are not willing to take a cut, or they don't. They will just get a salary and a bonus and they will not really be based on like the company's performance or their performance – no. And the thing is we will recommend to the board of directors that this needs to be adjusted and this person is being paid too high and we ask them to take a salary cut and they are obviously not very happy about that and don't generally do it – which is very sad, because then you know that … because also the banks feel that they are putting more money in and the company and management and board of directors aren't even taking a salary cut, so they are not sort of pulling their own weight."*

5.9 Conclusion

Eight of the nine respondents agreed that the major problem component that leads these companies into financial distress is most certainly the senior management team. They are either trading recklessly or are in a heightened sense of denial. One of the practitioners mentioned that he believes that the problem area is in the structural tier just below the senior management team; the workers at the front line. He believed that they tend to murky the waters and "paint a picture" that is not entirely accurate so as to impress the senior management team into believing that they are competent and deserving of increases/bonuses, and this is where the inaccurate accounting begins and ripples throughout the organisation.

In conclusion, it cannot be said that highly incentivised management teams are able to turn a distressed business around any better than a company that remunerates according to market value.

One of the respondents did however change the total incentive scheme for a mine that he was involved with. The original bonus structure went around the total amount of rock that was extracted from underground, and only underground workers would receive bonuses. He changed this to include each and every mine employee, and it was no longer based on the total amount of rock that was excavated, but rather on the profitability of the mine as he was concerned that workers were laying claim to any rock that they could, instead of it being ore-bearing rock.

Finally, in the context of the interviewees and their personal work acceptance, this proposition is not supported.

5.10 Results: Research Proposal Five - Organisations that have a Z-score < 0 have less chance of surviving business rescue and returning to sustainable activities as the financial crippling is too severe

5.10.1 Introduction and Overall results

In hind sight, this was a proposition that the researcher feels was the most unsuccessful from a response rate regarding the content and value that was derived. Only one of the interviewees makes use of a particular model when analysing a distressed business and it was not the age-old model of the Z-score. This was the section of the interview that brought about the most "gut feel" responses from the respondents. BRP6: *"Uhm… it's just getting back to the text book – I just look at the figures and my gut tells me… Well I suppose indirectly the things that I look at are probably ratio driven, but I don't purposely go and do ratio calculations."*

All of the respondents preferred to call upon the services of accounting firms to validate the financials (again adding to the cost of business rescue). All that they were interested in was how much money was available to get this distressed organisation through the next few weeks/days before they could hopefully secure PCF.

BRP8: *"To be honest with you we are just looking at Rands and cents."*

BRP1 mentioned *"What you will find is they do not really speak about those things because that is kind of where some of the intellectual property could be found. They don't really want to share with you how they do it but they do it."* This is most definitely a hindrance to the process; however, it is most certainly an understandable view point.

To gain insight from this particular aspect of the interview, the researcher did manage to extract from the interviewees some of the financial ratios that they believe to be key to analysing the severity of the financial position of the distressed organisation. Below is a brief table highlighting some of the ratios that were mentioned by the experts as being crucial.

Ratio/Analysis	**# of Respondents**
Cash Flow Analysis	9
Solvency & Liquidity Ratios	6
Net Asset Ratio	2
Regulatory: PAYE & VAT outstanding	2
Debt Ratio	1

The reason for the high response rate regarding the Solvency and Liquidity ratios, may be due to the fact that it is a prerequisite to filing for business rescue, and it is stipulated in the Act that is must be provided when applying to the court for a licence to place the distressed organisation into business rescue. BRP2: "*We are forced to do a solvency and liquidity test. That is what the Act requires. There they say if the thing is already insolvent you can't really file for business rescue. Now that is true in one sense, but you need to look at your solvency ratios and your liquidity ratios. Those are the two that I look at. If it is insolvent I will look at the reason why it is insolvent. It could be that you've got… in South Africa you have this unique situation where you can start a company with R100 so you have your own capital there for R100 and you have a serious loan account of R20million or whatever. It is allowed to subordinate that to all the creditors, and suddenly you have a solvent company. You look at those kinds of ratios – why is it solvent? What type of accounting are they applying? Is there quasi-capital locked up in the balance sheet that can actually be construed as capital and those kinds of things."*

Understandably, cash flow is the one main statement that is required by all the practitioners in order to determine how much "fuel is left in the tank" and what amount of PCF will be required, and if it is financially worth it to them as professionals as well.

5.11 Conclusion

None of the interviewees make use of any particular analytical model to determine the severity of the organisation, least of all the Z-score model. This may be the case, or it may not and the respondents wished to view this section of the interview as their intellectual property and were not too forth coming, which is entirely understandable.

A few ratios are used on the odd occasion to assist the practitioner with, what the researcher believes to be, designing the presentation to potential post commencement funders as they may want to see certain ratios.

On the whole, this was not a particularly fruitful section of the interviews and may need to be revisited in further research.

Finally, given the reluctance of the interviewees to divulge too much information regarding this proposition, the researcher feels that it may not be totally discarded and may be a topic for future research.

CHAPTER 6

6.1 DISCUSSION OF RESULTS

6.1.1 Introduction

The previous chapter laid out the findings from the research process, in which five propositions that were derived from the literature in chapter two of this research, were tested by conducting nine, semi-structured, in-depth interviews with nine industry experts in South Africa.

This chapter will look to interpret and discuss the findings from the previous chapter, with reference to previous research carried out on business rescue, and more specifically, in South Africa.

The body of literature that currently exists in the industry was utilised to derive the five propositions as well as the in-depth questions. The five propositions were held by the data, with a few sub-themes emerging a lot stronger than others.

The results that will be discussed in this chapter, aim to add to the already existing body of knowledge with regards to business rescue and turnarounds.

6.2 Research Proposition One - A checklist can be created that assesses certain company aspects prior to its filing for business rescue, which will assist the stakeholders to determine the potential outcome

The aim of this proposition was to determine if there are any clear aspects of a distressed organisation that the practitioner should look into before accepting or declining to be appointed to the task.

According to the practitioners, there are eight distinct areas that need to be considered when conducting a pre-assessment on a business that is distressed and wanting to enter into business rescue.

1. Access to post-commencement finance
2. External environment that the organisation is participating in
3. Accurate and up to date financial statements
4. “Gut feel”
5. Overview of who the major creditors are as well as the availability of free assets
6. Is there still a product
7. Skill levels of the board/senior management
8. Can this organisation afford the “BRP”

Access to PCF still remains at the top of the discussion lists as all the interviewees agreed that it is nearly 100% necessary in order to successfully rescue a business. This was validated by Pretorius (2014) when he mentions the unwillingness of banks to maintain financial assistance to distressed organisations that are in business rescue is “not helping the problem.” Pretorius (2014) mentions that there are “lots of unscrupulous people” who are stretching the process of business rescue so as to increase their fee earning period and this is leading to a breakdown in trust between banks and business rescue practitioners. Although the quality of the practitioner may not be assessed by the practitioner himself (bias) and deemed a pre-assessment aspect, it is however a significant facet that must not be overlooked by other stakeholders as all the respondents mentioned that the overall level of expertise in the industry is not very high. This may also be expected as the industry is still only three years old and many practitioners are still "finding their feet."

With regards to the skill levels of the senior management team, this would go hand in hand with the size of the organisation, as smaller businesses generally do not attract the most skilled individuals (or many of them at least), and this leads to voids when the practitioner must take over. Campbell (2012) measured "profitability" on an efficiency ratio in terms of return on total assets. He found that companies that displayed swift actions through efficiency-orientated strategic moves, had a greater tendency to turnaround. This swift action may also highlight the level of business acumen that exists within an organisation as they were not in denial and that they responded "in time"! Many interviewees highlighted that businesses were left too late and were too financially distressed when the practitioner arrived.

Although Trahms et al. (2013) found that equity-linked compensation results in a stronger alignment and allegiance to the organisation, and that Campbell (2012) noted that an executive's personal wealth strongly influences their speed in execution of strategies, this did not appear to be the case from all nine the respondents.

Even though, Argenti (1976) discussed his six aspects of failing businesses many years ago, his insight into the fact that bad management in senior echelons are more often than not the cause, still remains exceptionally accurate. These six elements were apparent in failing business rescue attempts:

1. The chief executive officer is an autocrat. Instead of being a leader, the CEO dominates and intimidates his/her colleagues. This was particularly evident in small businesses where the persona of the owner and the organisation cannot be split.

2. The majority of the board members do not participate in the day to day affairs; hence they cannot pass valuable comment as top management. Departmental or specialist directors tend to leave key decisions up to the general management to make. Again, this was a characteristic that was displayed by smaller to medium businesses.

3. The company's chairperson is also the company's chief executive officer.

4. The knowledge and skills of the board are not balanced. For example, there may be too many marketing directors and no engineering skills on the board.

5. The finance function is weak or not at all representative on the board. This ties particularly strongly to the accuracy of the financial statements of the organisation or the non-existence thereof.

6. The depth of management skill in the tier just below the board of directors is not sufficient. This was highlighted by one of the practitioners as the department that starts to murky the waters and the "inaccuracy" begins here.

In conclusion, and by understanding that each business is different and operates in unique markets and under unique market conditions, the eight elements above need to be addressed and understood before the organisation can file for business rescue.

6.3 Research Proposition Two - Free assets are the most important variables in determining the likelihood of a successful business rescue

The words from Campbell (1996) and Routledge and Gadenne (2000), where they all agreed that the "free asset" variable is a significant predictor of business recovery, appeared to almost echo throughout every single interview. This statement could not have been any closer to the responses that were given by the interviewees. Further, Campbell (1996) and Routledge and Gadenne (2000)'s words were again confirmed that the limitations of the information that can be found in financial statements, often makes it impossible to determine which assets have already been used as collateral for secured lending. Many of the experts highlighted the fact that the inaccuracy of the financial statements made it extremely difficult to fathom which assets could or could not be used.

As mentioned by the professionals, many companies have borrowed "to the hilt" and the debt ratio, although not explicitly mentioned, which is also known as gearing, refers to a means by which an organisation is able to use borrowed money (debt) to "gear up" or "lever" its profits (Graham & Winfield, 2007). This ratio allows the practitioner to evaluate the extent to which an organisation uses debt and hence understand the organisation's risk-return profile.

This data, that was extracted from the interviews, is particularly similar to the existing research regarding free assets and their ability to ease a company's pain throughout its distressed period and successfully see it to sustainable operating levels again.

6.4 Research Proposition Three - Larger companies have a greater propensity to survive business rescue proceeding than smaller companies

The words of Smith and Graves (2005) could also not be any closer to the truth, as they stated that larger firms are generally better equipped to raise additional funding than smaller firms. This was confirmed by all the interviewees as they mentioned that the senior management teams and organisational structures make it that much easier to deliver and execute on a business rescue plan as well as the ability for the organisation to afford the business rescue. This is possible, as these organisations would have excess employees that could be retrenched in order to increase efficiency as was stated by Ndofor and Sirmon (2013), where they state that retrenchments and strategic actions are crucial to the survival of the business. By retrenchments they infer operating cost and asset reduction and that strategic action are those actions undertaken to change or adjust an organisation’s domain and how it competes within these domains

According to McKinley et al. (2014), the second step of rigidity is seldom an option for smaller businesses as majority of the resources are “sweated” at any given time; hence turnaround through innovation is the only perceived option for a turnaround.

Although, not specifically mentioned in the previous chapter, family run businesses proved to be more of a headache than anything else with some of the practitioners vowing to never accept a family-run business ever again. These organisations tended to have unskilled family members in crucial management positions and this led to the void that many practitioners discussed that made it incredibly difficult to deliver a plan to. According to Morrison (2007), 86% of businesses, during a study that was carried out, were managed and owned by either a small group of shareholders or by family members and they failed to be rescued from Chapter 11 bankruptcy in the USA.

In conclusion, smaller businesses lack the resources to successfully orchestrate a business rescue or endure the pain and suffering for an extended period. It is currently not viable for smaller businesses to enter into business rescue and they should instead be liquidated.

6.5 Research Proposition Four - Companies that have highly incentivised top management teams have a greater tendency to endure business rescue and return to sustainability

This proposition was proven inaccurate by all the practitioners as they had said that they had never seen that there is a causal correlation between the incentive structure of the senior management teams and the potential for success.

Despite the findings by Trahms et al. (2013), that equity-linked compensation results in a stronger alignment and allegiance to the organisation, this appeared not to be the case and that management would either be passively aggressive, or they would “jump ship” while they still could. It was very seldom noted that senior management had even taken cuts in their salary and this could be the exact opposite to what Trahms et al. (2013) mentioned, in that perhaps these top management teams were not interested in the organisation and only cared for their own personal well-being.

In conclusion, this aspect of the interview was proven to be 100% inaccurate and that management, who are highly incentivised, are not necessarily going to assist the practitioner, or the organisation for that matter, to work through the distressed period of time.

6.6 Research Proposal Five - Organisations that have a z-score < 0 have less chance of surviving business rescue and returning to sustainable activities as the financial crippling is too severe

This proposition generated responses that the researcher feels may have been answered to protect certain intellectual property by the interviewees, and understandably so. The general answer to the questions pertaining to this topic were, “I just look at how much money there is!” or “I just trust my gut.” These are not typically academic answers. Although, after many years in the turnaround industry, as most of these experts have been, they do tend to develop “sixth senses” but this may not be entirely true.

None of the respondents make use of the Z-score model, where one of the interviewees makes use of the Du Pont model. According to (Graham & Winfield, 2007), there are three ways to monitor a company’s return of equity (ROE); the first way is to determine if they are using their assets efficiently and this can be measured by making use of the total assets turnover ratio (Revenue ÷ Total Assets). The second calculation is to determine if the organisation is making the highest possible profit and this is done by calculating profit ÷ revenue x 100. Lastly, is to determine if the company has the optimal mix between debt and equity. (Total Assets ÷ Total Equity) (Graham & Winfield, 2007).

$$\text{ROE} = \frac{\text{Profit}}{\text{Total Equity}} \times 100 = \frac{\text{Revenue}}{\text{Total Assets}} \times \frac{\text{Profit}}{\text{Revenue}} \times 100 \times \frac{\text{Total Assets}}{\text{Total Equity}}$$

Further than this, the researcher was unable to delve. Cash flow analysis remained an absolute necessity amongst all the experts, and a few indications such as unpaid taxes were common. Other than this, there appeared to be no financial frame work that is being used by the practitioners in the field.

In conclusion, assuming that responses were accurate and that the interviewees did not withhold certain information, there appears to be no framework or model used within the business rescue industry in South Africa to determine the severity of the financial position of the organisation.

Chapter 7

7.1 Introduction

The previous chapter looked into the existing literature in business rescue and discussed the findings from the nine interviews in light thereof. This chapter highlights the objectives that outlined for this topic and will then summarise the key findings regarding a pre-assessment to business rescue in South Africa.

After considering the limitations to this project, the recommendations to stakeholders entering a business rescue are mentioned as well as recommendations for future research.

7.2 Research background and objectives

With the newness of Chapter 6 of the Companies Act 71 of 2008 in South Africa, and the dismal performance that has been experienced over the past three years since its inception in mid-2011, the researcher believed that there may be some indicators that could assist stakeholders in assessing the potential of the business before it enters business rescue to help determine the potential outcome. With Terblanche (2014) in mind, where he states that the success rate of business rescue in South Africa is between 12 and 15%, the problem was clearly highlighted and some form of pre-assessment is required.

The objective of this research was to determine the glaring characteristics that arise before and during a business rescue and to bring these to the attention of the larger business community within South Africa. Critical success factors have come to the fore throughout this project.

It is felt, that to some degree of confidence, a guide to pre-assessment has been achieved.

7.3 Main findings

After in depth interviews with nine experts in the field of business rescue in South Africa, common trends emerged that have been verified to existing literature. This research does however expand and contribute to the existing literature on business rescue, particularly in South Africa.

The findings can be consolidated into one larger conclusion as they all relate to the first proposition from Chapter 3 of this research.

Post-commencement finance remains the most important characteristic that is required to even commence with business rescue. As practitioners, they must be sure that they know how much PCF they require, when they will require it as well as how/where they will acquire it from. The practitioner may have a fundamentally sound rescue plan, but if there is no PCF on the horizon, then it will be better to place the organisation into liquidation. Many of the creditors are beginning to understand business rescue better within South Africa, and are a lot more willing to assist the process, when there are at least two things in place: 1: The levels of communication with them are adequate and accurate and 2: The practitioner is experienced and not accepting the appointment in order to "bleed the organisation" over the coming few months and then place it into liquidation, as it perhaps should have done earlier.

PCF is substantially easier to raise when there are free assets in the business that may be offered up as collateral to the new creditors. With the ambiguity surrounding the ranking of post commencement funders, collateral is always a sure way to lure the much needed funds. It is important for practitioners to determine what the accurate levels of assets are within the business, as often the financial statements are inaccurate and not up to date. This may lead to a false sense of security and place the business in an even weaker position.

Smaller businesses cannot afford to enter into business rescue, and hence they should almost immediately opt for liquidation or another alternative such as informal restructuring. The option of business "workouts" and turnarounds should perhaps not be ignored. However, based on the responses from the nine experts in the fields, smaller businesses cannot afford the exorbitant costs associated with business rescue. Currently, based on the responses from the interviewees, the threshold for business rescue appears to be slightly under the R50million annual turnover amounts. This will most likely still need to be verified and may be a potential future research endeavour.

The one aspect that not did appear to correlate to the existing literature was the notion that highly incentivised senior management are more likely to turn an organisation around, than those that are not. The only conclusion that could be derived from this section was that senior management is very often in denial, and they would rather continue to draw down their monthly salaries and ensure that bonuses were paid in full, before the company files for business rescue. In all but one case, the management team's salaries were all paid in full upon the arrival and appointment of the business rescue practitioner. The retrenchment of individuals during business rescue is still proving to be a difficult area within the legislation, which many of the experts feel needs to change. Their rationale for the change is that they do not correlate and coincide with the rigorous timeframes of business rescue, and they still prove to be exceptionally expensive during the rescue phase. So, many practitioners have found it better to "move" individuals who are not aiding the process to less important and more mundane areas of the company, so as to only work with the employees that wish to try to save the "sinking ship."

None of the practitioners make use of any particular financial model to help them determine the severity of the financial position that the business faces. More often than not, they outsource this task to smaller auditing firms to help them understand the position of the business. Cash flow, cash flow and more cash flow is one of the most important aspects of the rescue. Many practitioners are faced with having to generate their own cash flow statements when they first arrive at an organisation given that the struggling companies tend to neglect this aspect of the business during distress. This is a clear example of inadequate financial managers and more than that, an inadequate CEO who has been making decisions on no clear structure. This is a further reason why smaller businesses are often not candidates for business rescue as the levels of skill within the organisation are not adequate.

7.4 Recommendations to stakeholders

Business rescue is a consultative process where levels of communication must be at their highest with all the stakeholders, particularly between the BRP, the employees and the creditors. If unsuccessful, business rescue will erode further value from the organisation, and this will lead to even lower levels of dividend being allocated after liquidation.

Not any practitioner should be appointed to the business, and it is recommended that there be at least two reviews (if time allows for it) by different practitioners. The researcher understands that this may further erode value from the distressed organisation, however it is advisable to get seek a second opinion. The legislation is still very new in South Africa and this Act will still need to be tested again and again. Many practitioners are in agreement that there most certainly are changes required, however, given the newness of the Act, it should be allowed to run its course for a little while longer so as to iron out any more glitches in the system.

All stakeholders should become more familiar with the Act so as to better understand it, and to help the entire industry benefit from it and begin to turn around this negative aura that is developing around business rescue in South Africa.

7.5 Limitations of the research

One of the limitations to this project is that this is not a blue print and will not determine with 100% accuracy what the outcome will be if an organisation enters into business rescue. It will, however, guide stakeholders to make more informed decisions before accepting and/or declining business rescue. In order to determine firmer characteristics, quantitative and/or qualitative research will need to be conducted that tests casual links between certain actions.

Another limitation to this research was the use of experts from a singular region of South Africa. This may have prejudiced certain findings; however, the researcher was unable to venture further than Gauteng, South Africa, to conduct this research due to time and financial constraints.

A third limitation may have been the bias preceding this work, as the researcher was a creditor that experienced one of the first unsuccessful business rescue cases in South Africa first hand in 2011.

An additional limitation that should be considered is that the short list of interviewees was derived from the researcher being made aware of their names through the initial literature reviews as well as the comments in the press surrounding business rescue. This led the researcher to possibly interview BRPs that only take appointments in larger organisations that can afford their fees.

A few potential future research questions have been extracted below for further studying.

7.6 Recommendations for future research

With this legislation still being relatively new in South Africa, the purpose of this study was to add to existing theory as opposed to testing it. A future proposal to study may be an exploratory study that tests the differences between two organisations (failed and rescued) that are in the same industry with similar structures and test to see where they were similar as well as what each did differently and attempt to derive "success factors" or "warning signs".

Future studies may aim to test and confirm the concepts (all or some) from this research. It is proposed that it be tested by interviewing "lesser" known BRPs and testing if they have the same approach to business rescue regarding organisational size.

An additional concept may be to test the success indicators from the perspective of the senior management teams within the organisations that have experienced business rescue in South Africa and how they observed what the BRP did and how he conducted himself. This may give additional insight into the behaviour of successful BRPs.

Further areas for research may include:

- The impact that the banking industry has over the success rate of business rescue in South Africa.
- Proposed changes to Chapter 6 of the Companies Act that may be required to assist stakeholders as a whole in rescuing a business.
- A study relating to the experience of the BRP, their fees and their success rates.

7.7 Proposed framework

The researcher understands that no two business rescues are the same and that each distressed organisation is faced with its own unique set of challenges. With reference to the findings from Chapter five of this study and the frequency and emphatic responses that were generated by the BRPs, the framework below, although non-quantitative, will assist stakeholders as a generic starting point to assessing their organisation to help them determine if it should consider business rescue. It is still however strongly advised that an experienced BRP do a pre-assessment.

Weak, negative response

Strong, positive response

Likelihood that the full amount of PCF will be raised in time										TOTAL (%)
3	6	9	12	15	18	21	24	27	30	
Skill level of the BRP										
2	4	6	8	10	12	14	16	18	20	
Size of the organisation (in annual turnover)										
2	4	6	8	10	12	14	16	18	20	
Amount of time available to the BRP (severity of financial distress)										
2	4	6	8	10	12	14	16	18	20	
The business's position within the market and external environment										
1	2	3	4	5	6	7	8	9	10	
Guiding total percentage to determine if business rescue should be pursued										

The above framework is proposed as a guide and cannot be used as emphatic rational to proceed with business rescue. However, it does address the key focus areas of a distressed organisation and allows all stakeholders to briefly glimpse into the likelihood of a rescue.

7.8 Conclusion

South Africa has only seen this new legislation in action for a little over three years and to date has had very little success. A lot of this may be attributed to the fact that businesses that should have filed for liquidation, instead, opted to test Chapter 6 of the Companies Act and attempt a business rescue.

With this Act still being in its infancy, the entire industry will still need to go through a learning curve as there are many individuals who are attempting to become practitioners, yet lack the necessary skills. There are also currently very few, if any, structures in place to govern the behaviour of business rescue practitioners which has led to exploitation in certain instances.

To try and mitigate the erosion of value from the businesses, as well as to protect the other stakeholders in the process, this research contains crucial aspects that need to be considered and some not, prior to entering business rescue. It is by no means, 100% assured to give an accurate prediction, as all businesses are different and are trading in a vast array of conditions, with numerous market forces at play. However, it does bring to the fore points that require serious consideration before undertaking the grueling, strenuous task of business rescue. The best course of action is to partner with a reputable practitioner in the early stages of distress.

"You've got to know when to hold 'em, know when to fold 'em, know when to walk away, and know when to run!" – Kenny Rogers

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APPENDICES

Appendix 1

Companies and Intellectual Property Commission Republic of South Africa

Companies and Intellectual Property Commission
Republic of South Africa

Form CoR 126.1

About this Certificate

- This Certificate is issued in terms of section 138 of the Companies Act, 200,8 and Regulation 126 of the Companies Regulations, 2011.
- The filing fee for this Application is R 500.

Contacting the Commission

The Companies and Intellectual Property Commission of South Africa

Postal Address
PO Box 429
Pretoria
0001
Republic of South Africa
Tel: 086 100 2472

www.cipc.co.za

Application for Practitioner's Licence

Date: ______________________

To: **The Commission**

From:
(Name Identity Number, address and contact details of Applicant)

Name: ______________________

Identity No: ______________________

Address: ______________________

____

Telephone No: ______________________

Email: ______________________

The above named person applies to the Commission in terms of section 138 (1)(b) of the Companies Act. 2008. for a license to serve as a business rescue practitioner. in terms of the Companies Act, 2008.

In support of this application, I have attached -

1. A resume of my history and experience engaging in business turnaround practice, as defined in Regulation 127 (2), if any.
2. A resume of my relevant education, experience and professional affiliations.

In further support of this application, I declare that I am not disqualified from serving as a business rescue practitioner on any grounds contemplated in section 138 (1) (c) or (d) of the Companies Act, 2008.

Name and Title of person signing on behalf of the Applicant:

____

Authorised Signature:

____

This form is prescribed by the Minister of Trade and Industry in terms of section 223 of the Companies Act, 2008 (Act No. 71 of 2008).

Appendix 2

List of interviewees

Name of respondent	Company Name	Role/Responsibility	Nature of expert
Peter van den Steen	V-Squared Business Rescue Service	Director/Founder	Business rescue practitioner
Keith Fairhurst	Unleash Consulting	Director	Business rescue practitioner
Dawie van der Merwe	Corporate Recovery Advisors	Director	Business Rescue
Trevor Murgatroyd	TM Restructuring	Director	Business rescue practitioner
Gert Holtzhauzen	Strategic turnaround solutions	CEO	Business rescue practitioner
Leslie Matuson	Matuson Associates	Shareholder	Business rescue practitioner
Jenna Osborne	Matuson Associates	Associate	Business rescue practitioner
Eric Levenstein	Werksmans	Partner	Attorney specialising in business rescue, restructuring and insolvency law
Marius Pretorius	University of Pretoria	Professor in Strategy, Leadership and Turnaround	Professor in Strategy, Leadership and Turnaround

Appendix 3

Questionnaire

Research Question	Questions	
RQ1:A checklist can be created that assesses certain company aspects prior to its filing for business rescue, which will assist the stakeholders to determine the potential outcome	1. Please briefly describe your assessment process that you follow before determining if the company/organisation can be rescued with the assistance of chapter 6 business rescue and/or the criteria used to determine whether they will take on a BR in the 1st place? 2. Are there any main aspects of the business that you focus on when doing your initial assessment and why? 3. I understand that each case is unique, but what are the glaring communalities to businesses in financial distress? 4. Do you ever consider the external environment that the distressed organisation finds themselves in? If yes, how in depth is your analysis of this aspect? 5. If yes to Q4, have you been more successful in turning businesses around that are in a saturated market or a new dynamic market? 6. Why would you say this? 7. In your experiences, what would you say is the main reason that you fail to rescue a business? 8. In your experience, how have creditors reacted to business rescue? 9. Have you experienced a difference between companies that provide a service and companies that provide a product? 10. If yes, what have been the biggest differences? 11. If you have been required to retrench employees, where do you typically start? Do you adopt a top down or bottom up approach? 12. What would you say the average day's inventory holding was that a distressed organisation had when you began business rescue?	
RQ2: Free assets are the most important variables in determining the likelihood of a successful business rescue.	1. According to many surveys of late, PCF is proving to be a tricky hurdle to overcome. How have you managed this hurdle? 2. What has been in place in a company that you presided over where it was the easiest for you to raise PCF? Success factors? 3. What are the internal (distressed companies) challenges that you face when trying to raise PCF? 4. When you enter a company with the intension of rescuing it, do you find that the majority of the assets are already collateralised? 5. What percentage of success would you attribute to the ease (and required amount) of raising PCF to the success of the business rescue. 6. Often PCF may not require free assets (venture capitalists), would you say that free assets do assist you in raising PCF?	

	7. Who are the lenders that typically assist with PCF? 8. Who are the lenders that are the most difficult to convince to assist with PCF? 9. What are the main reasons for your two previous answers? 10. Do you have any suggestions as to how the industry could benefit in this area of PCF?	
RQ3: Larger companies have a greater propensity to survive business rescue proceeding than smaller companies.	1. How many companies have you been involved in as a BRP? How many have been companies with less than R5million in turnover? 2. How many have been organisations with between R5million and R35million? If yes, how many (estimate). 3. Have you been involved in a business rescue where the organisation had a turnover of more than R35million? If yes, how many? 4. I understand that larger organisations may be more complex, and require more resources from your side, but what are the upsides to managing a turnaround in bigger organisations vs a smaller organisation? 5. Now the opposite, what are the benefits to managing a turnaround in smaller organisations vs a larger one? 6. Considering only company size; which size organisation do you feel is easier to turnaround (other factors aside) and why? 7. Have you been asked to rescue a family run business before? If yes, what were some of the pros and cons to that?	
RQ4: Companies that have highly incentivised top management teams have a greater tendency to endure business rescue and return to sustainability	1. What is your opinion on keeping the majority of the management team in place during business rescue? 2. What is your opinion on keeping the majority of the management team in place after business rescue? 3. What is the position (top management) that you find “houses” the most “crippling” individuals? CEO? CFO? 4. What have you found is top management’s opinion on “budging” with regards to their salaries/bonuses 3 months prior to and during business rescue? 5. Would you say that top management within these organisations are largely remunerated based on performance? What have you found to be the other measurements used? 6. Are these top individuals highly incentivised to perform or are they merely remunerated? 7. Have you ever changed the incentive scheme for an organisation post business rescue? What where the key aspects that you addressed?	
Q5: Organisations that have a z-score < 0 have less chance of	1.How do you measure how severely impacted the business is financially? Is this your own method or an industry norm/method?	

surviving business rescue and returning to sustainable activities as the financial crippling is too severe.	2.When looking at the financials, what are the most important ratios that you look for and why? 3.Have you ever noticed that the financial statements are not entirely accurate? If yes, please elaborate on past experiences? 4. Do you follow the framework of any particular model/test to determine the likelihood of a rescue? 5. If yes, which one/ones and why?	
Further questions	1. What are the two biggest hurdles to business rescue in South Africa and why? 2. Do you feel that legislation needs to be altered? If yes, how and why? 3. What stages of distress are you typically called into the organisation? 4. What stage have you found will lead to a better success rate? (Please elaborate.) 5. Do you believe that business rescue practitioners are perhaps not experienced enough in South Africa?	

Appendix 4

Letter of consent

Gordon Institute
of Business Science
University of Pretoria

INFORMED CONENT LETTER

I am conducting research towards my Masters of Business Management (MBA) at the Gordon Institute of Business Science (GIBS) on a pre-assessment checklist to 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 any 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 pre-assessment to business rescue in South Africa and therefore add to the theory base as well as the understanding of the practise in this new industry. Our interview is expected to last approximately an hour, and will enrich business rescue practitioners, scholars and any interested parties to understand the nature and importance of pre-assessment to business rescue in South Africa as well as the prerequisites for success. Your participation is voluntary and you may 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 below.

Researcher details
Vincent Prior
vincentprior@gmail.com
083 566 1488

Supervisor details
Wanya Du Preez
wdupreez@deloitte.co.za
083 272 0892