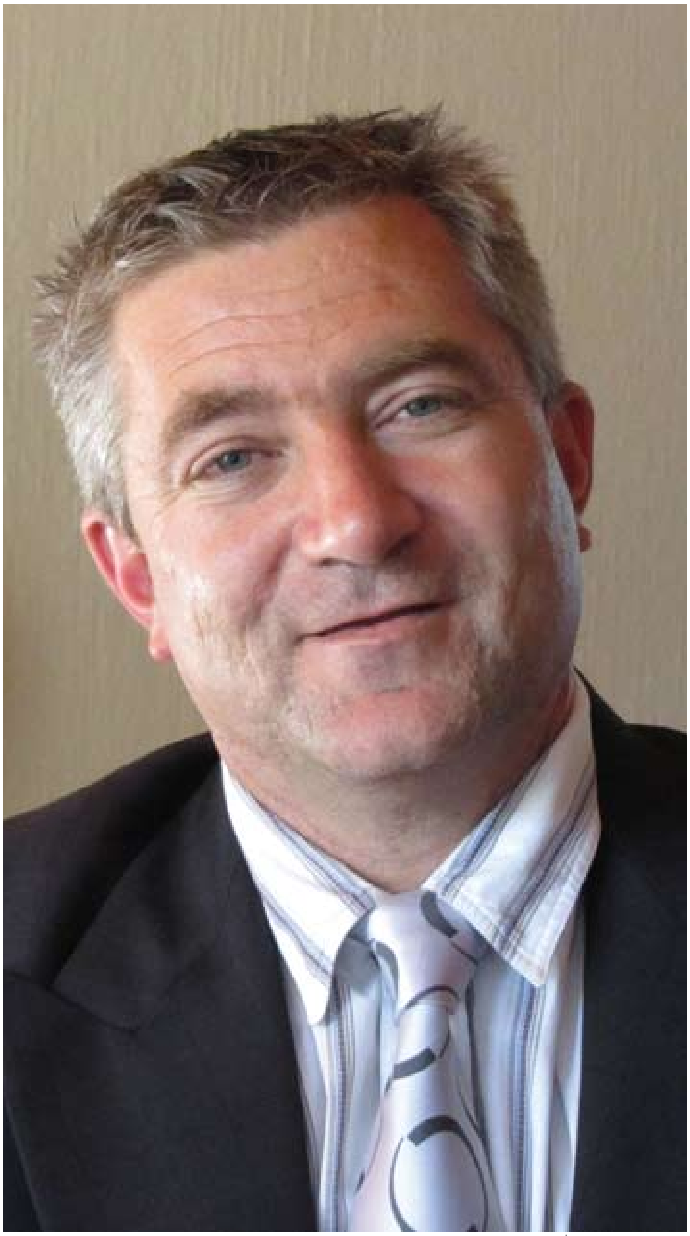
WHAT WILL BUSINESS RESCUE ACHIEVE?

by Dimeon van Rooyen

The revamped Companies Act of 2008 provides struggling businesses with all the help they need to get out of trouble with business rescue legislation, as set out in Chapter 6 of the Act. The question is: Will business rescue be effective in assisting failing companies to turn their fortunes around?



Stefan Steyn

Critics maintain that under the previous Act it was too easy to liquidate a business in trouble by those who had a vested interest in getting quick money out of the business, destroying valuable jobs in the process. The new provisions could, however, merely postpone the inevitable.

Financial expert Stefan Steyn says, "The overall theme of Chapter 6 is to see if it is possible to assist businesses that are temporarily stressed, in order to ensure jobs are not lost. Often, businesses are sound enough to survive but struggle under temporary restraints."

There are two routes a distressed business can take. The first is a Section 129 decision, where directors look at their statements, realise the business is in trouble and are required by law to inform all affected parties that the business has applied for business rescue. They can also decide against business rescue, in which case they also have to inform these parties, but then the directors are liable for whatever happens to the business. In this instance, the business is able to appoint its own practitioner.

Section 131 business rescue is where creditors, other affected parties, unions or even employees apply for business rescue through the Supreme Court, when there are clear signs that the business is

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in financial distress. Here, the affected person nominates the practitioner, which will in all probability be rubber stamped by the court.

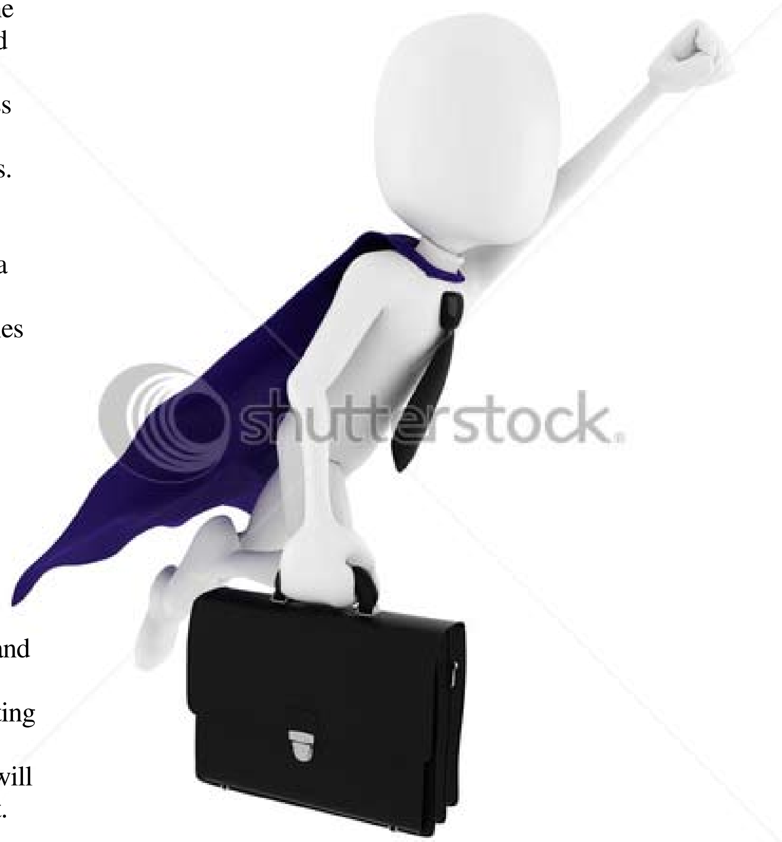
In each case, the company is assessed and when business rescue is approved, a business rescue practitioner is appointed who takes over the entire running of the business. Practitioners can give back rights to the business owner or directors at their discretion.

By law, the business rescue practitioner is able to place a moratorium on payments by the business to creditors for a limited period. During this time, only the employees' salaries and the fees of the business practitioner are paid from the company's revenue.

Suspended payments have the effect of protecting cash flow for the business for a limited time, but have the unintended consequence of putting stress on the creditors during that period.

Business rescue is a relatively progressive piece of legislation, with South Africa's move in this direction mirroring recent developments in the United States and Canada. The business rescue timeline is set out in the Act and is the same for all businesses.

"Within 10 days, the practitioner must call the first meeting of creditors," explains Paul Winer, director at Werksmans Attorneys. "Then, a business plan as to how the company will be rescued must be filed within 25 days of commencement.



"Business rescue may be controversial but in the end the pros outweigh the cons" – Jan van der Walt

"Payments to creditors can only be suspended until the plan is accepted or rejected. If a plan is rejected, another plan can be submitted by affected parties. If it is approved, it has to provide for the commencement of payments. Shareholders are only allowed to vote on the plan if it affects them, such as when part of the plan entails shares being forfeited.

"A business practitioner can also say that no measures are able to save the business and that it should move to liquidation immediately. Legislation provides for that."

The biggest talking point of business rescue is whether businesses are really being saved and if it is not merely postponing the inevitable.

The only way business rescue can work is if there is money to run the company from the very first day it is placed under rescue. There are companies abusing the legislation by filing for business rescue under Section 129 when they have cash flow problems. Instead of saving businesses it is mainly being used as a delaying tactic at the moment.

Steyn says, "Big businesses that go into business rescue are subject to different dynamics than smaller businesses. The former will probably have higher success rates because the creditors have more to lose. For smaller businesses, the success rate is going to be much lower."

While these predictions may sound gloomy, the low expected success rate is a function of the importance attached to saving as many jobs as possible. This is best explained from the example given of the different ways business rescue is implemented in other countries.

"In the United States, the commencement level for business rescue is very low, which means that many economically unviable businesses go for this process," says Jan van der Walt of Corporate Renewal Solutions. "Only a third of all business rescue plans are approved and 75% of approved plans are successfully implemented to give an overall success rate of 25%. In Canada on the other hand, the commencement level is much higher. The acceptance rate is 75% because only higher quality businesses apply, the success rate is 80% for an overall success rate of 60%.

"In South Africa, the commencement level is very low so the success rate is bound to be lower. Some businesses are clearly not viable but with those that fall into the grey area, you will not know until you do a full analysis.

"A low success rate should not be seen as a strain on resources because the money wasted on trying to turn around economically unviable businesses is small compared to the effect of saving a company. Taxes will continue to be paid and people will receive their salaries, both of which help the economy."

Given the complexities around struggling businesses, the success of the turnaround is dependent in no small part on the expertise and experience of the business rescue practitioner. Currently, business rescue practitioners are licensed to practice by the Companies and Intellectual Property Commission (CIPC) on an ad hoc basis.

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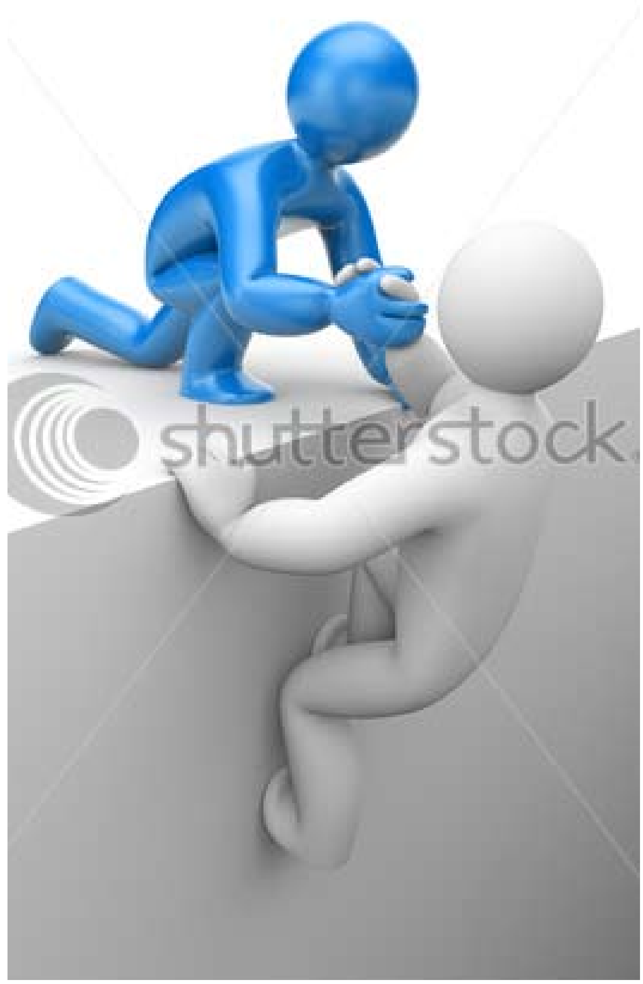
Because these practitioners are appointed by government, the business has no control over who will lead the turnaround. This is one area where the silent turnarounds of old had an advantage. Banks would approach practitioners with a reputation for turning businesses around to ensure that the best person for the job is at the helm.

Van der Walt predicts that larger businesses will still opt for silent turnarounds because of the stigma attached to business rescue. In fact, many large-name brands in South Africa have been brought back from the brink in this fashion, with the general public none the wiser.

The bigger businesses that go into business rescue will therefore only be those that the market already knows are in trouble. Smaller businesses will not always have this option, which puts them at risk of ending up with an inexperienced practitioner. The reason smaller companies prefer business rescue is the moratorium on creditor payments, which is not available through silent turnarounds.

In some instances, business rescue may force creditors to think twice before extending credit. However, this should not change the way business is done to any great extent, as businesses are already required by law to do background checks before they do credit transactions.



"Big businesses are already transparent, as required by law," says Steyn. "Transparency is going to cause some problems for SMEs because in the past many of them were run under the veil of being a business, while in reality being used as the director or owner's personal bank account. If the business rescue practitioner finds this to be the case, the owner's personal assets can be attached. Business owners are going to have to maintain a distance between their personal assets and the business.

"Business rescue has the potential to bring a new level of transparency and methodology to the way we do business.

"It is important for businesses to assess themselves once a year to see if they are in danger of going into business rescue, and what can be done to avoid it. In this regard, the internal audit of the business becomes very important."

If the business finds itself in trouble, a silent turnaround with a reputable practitioner may be a more viable option. Van der Walt says, "Business rescue may be controversial but ultimately the pros outweigh the cons. Many businesses will still fail, but in the end more will be rescued than before."