

**Will there be a need for informal loan workouts? A question from Chapter 6  
of the New Companies Act**

By

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## **ABSTRACT**

South Africa has recently introduced into law a new Companies Act that has, amongst other changes, a segment dubbed ‘Chapter 6’, which specifically focuses on distressed companies and their rescue/resolution. While past Acts in South Africa have had sections on distressed companies, none has positioned financial distress resolution as prominently within the Act as Chapter 6 has done. This hitherto lack of formalized focus of on business rescue in past Acts, made informal loan workouts the de facto mainstay for distressed business resolution in South Africa. It is therefore considered worthwhile that an investigation be undertaken to ascertain whether or not the newly legislated formal processes for rescuing distressed businesses will change the culture and/or overall view on the effectiveness of rescuing distressed businesses in South Africa.

An online questionnaire of 17 questions sent to 5 different occupation categories generated 61 responses, which were around four coherent themes. From the analysis of the responses it was found that the inclusion of Chapter 6 (formalized business rescue legislation) in the new Companies Act was a welcome legislation with clear value-additions to company law in South Africa. The results also indicated that there is a level of uncertainty with regard to this legislation; thus, suggesting it is likely that informal loan workouts will remain a real option for some businesses in distress.

## **DECLARATION**

I, Russell Searle, declare that the research work reported in this dissertation is my own, except where otherwise indicated and acknowledged. It is submitted for the degree of Master of Management in Finance and Investment in the University of the Witwatersrand, Johannesburg. This thesis has not, either in whole or in part, been submitted for a degree or diploma to any other universities.

Signature of candidate

Date

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## **Chapter 1: Introduction**

This introductory chapter provides the background to the study and the research problem, followed by a discussion of the study's research objectives. Consideration is given to the study's importance and the potential benefits of the study. Finally, a brief overview and orientation of the study chapters are provided as a round-up of this roadmap chapter.

### **1.1 Background information and the research problem**

South Africa has recently signed into law a new Companies Act. This new Act has been changed markedly from the previous Acts, in particular on the rescue or turnaround options available to distressed businesses. A new chapter, "Chapter 6: Business Rescue", has been included that focuses specifically on Business Rescue. While company law in South Africa has, since the Companies Act of 1926, provided for the rescue of distressed companies in one form or another, it has not been until the most recent Act (2008) that business rescue has been as prominently positioned within the Act. Pretorius & Hotzhauzen (2008) suggest that this new business rescue legislation is welcomed and supported by the South African business community. However, they also contend that this legislation has some shortcomings that may open up certain challenges and possible problems for the various stakeholders interested in the procedure.

Business rescue or turnaround is a complex process that involves diverse stakeholders, often with very different objectives as to what the result of the process should be. Despite the fact that Judicial Management has been a procedure available to companies in distress since 1926 in South Africa, no clear turnaround or rescue culture has been developed in South Africa. As a result, banks, creditors and non-financial services businesses themselves have typically relied on an informal process of distress workout. Bradstreet (2010) suggests that the move to more formal rescue oriented legislation in this country addresses two issues. Firstly, it is an attempt by the authorities to

improve and reform the unsuccessful procedures currently in use and secondly, it is the recognition that rescuing businesses has huge potential benefits to a country's economy and society.

The major problem thrown up by this laudable development on society's effort to manage distressed firms is whether the informal workout process will no longer be required considering the emphasis that the new Companies Act (2008) places on Business Rescue. In other words, is this new untested rescuing process comprehensive enough to retain and/or build on the virtuous "ad hoc" process that has hitherto served the South African business community? The new Act has brought in new thinking around business rescue that is materially different than past Acts as well as a formalized procedure that is very different to what was previously available to distressed businesses and their stakeholders. The complexities of Business Rescue, given South Africa's culture and history, and the challenges that similar procedures around the world have presented, lend support to the need to gain a deeper understanding of the evolving Business Rescue model in South Africa.

## **1.2 Objectives of the research**

The main objective of this study is to undertake an investigation into whether the newly legislated formal process of Business Rescue will result in a fundamental change in the culture and/or overall notion about rescuing of businesses in distress in South Africa. This fundamental change in the rescue process is related to the move to a more formal and structured procedure from the informal workouts that have been mainly in use up until now. A further objective of this study is not to predict or find a solution to business distress problems but rather to attempt to gain an early insight into perceived effectiveness of this new procedure from a selected sample of informed and interested individuals. Given the weaknesses of past legislation with respect to the rescue or turnaround of distressed companies and the lack of a rescue culture in South Africa, informal workouts were the natural choice. Therefore,

any attempt to gain early insight into this new formalized procedure is important (Loubser: 2010).

### **1.3 Importance and benefits of the study**

Businesses are important parts of any society and they perform critical and integral roles in communities, and the failure of any business has a multiple effects on its surroundings and stakeholders (Carrol & Buchholtz, 2006). Failure of a business often has a large effect on its employees who are likely to be without a job for a period of time, to its customers who may themselves come under difficulty as a result of non-payment. As a result, the new legislation concerning business rescue is important and can potentially offer great benefit to society or cause major problems. A study that helps shed light on this new legislation is of importance to all stakeholders and will provide benefits to those people or businesses that are potentially affected by this legislation.

A further benefit of this study is that very little research on the new Companies Act (2008), or more specifically Chapter 6, has been undertaken. For this reason research is needed in order to gain a good understanding of the Act. Future research can then be built on the back of this early research. Future research can also use, and improve on, methodologies and ideas of this early research to deepen the understanding of the Act.

### **1.4 A synopsis of the research method**

The research will be conducted using primary data research methods. Essentially a sample of Business Rescue Practitioners (Practitioner) and other stakeholders are surveyed. The survey is delivered online and sets of statistical analyses of the survey responses are carried out to derive significant research findings. More detail on the research method is given in Section 3.1 below.



### **1.5 Brief orientation and chapter overviews**

This particular chapter provides background information to the research problem. A natural progression of thoughts yields a systematic set of objectives of the research. A discussion of the importance and benefits of the study is provided and a synopsis of the research method concludes this introductory chapter.

In Chapter 2, a literature review is presented, with a definition of what an informal loan workout is relative to what business rescue is, and how it is presented in the new Act. This section also reviews how business rescue was considered in South Africa under past legislation. The literature review also provides insights into relevant international comparisons. Finally, the review looks at what possible issues or potential problems there may be, as identified in the review, in the formal process as set out by the Companies Act of 2008.

The research design and methodology are presented in Chapter 3. This chapter, over and above the design and methodology of the research, also discusses the nature and form of the report on the study. Further it presents the limitations of the study, and any ethical considerations that may have arisen and need to be explained.

In Chapter 4 of this paper the results of the survey are discussed including a summary of responses to the survey and an analysis of the responses based on four unifying themes, namely Theme 1: Questions related to the new legislation; Theme 2: Questions related to the costs, both direct and indirect, of the legislation; Theme 3: Questions related to the Business Rescue Practitioner and Theme 4: Questions related to the Business Rescue Plan. The conclusion to the paper is provided in Chapter 5 including a summary of findings, conclusions and suggestions for further research.

## **Chapter 2: Literature Review**

The literature review will present an understanding of the various issues related to the research problem. The review focuses specifically on four issues that are of particular relevance to this study. These four issues in question form are: what is an informal loan workout? What is Business Rescue and how has it been used in South Africa before now? And International comparisons and possible issues that may affect the use of Business Rescue as conceptualized by the new Act.

### **2.1 What is an informal loan workout?**

An informal workout of a business in distress usually only involves the business in distress and its principal creditor or creditors, which are typically the debt providers or loan institutions. Seldom are trade creditors taken into consideration and even less seldom are other peripheral, but often just as important, stakeholders seriously considered in an informal loan workout. An example of these other stakeholders is employees. This is especially so with respect to smaller businesses where much of the negotiation is done largely in private. An informal workout is also negotiated outside of any court proceedings, in many instances through a private negotiation (Chatterjee, Dhillon and Ramirez, 1996) and if only the debt is restructured then this negotiation may only be between the distressed company and the particular lending institution or institutions.

In business rescue or turnaround situations, liquidity and access to financing can be a major problem for the business and as such there is a need for the business to maintain relations with key creditors and suppliers (Whitman & Diz, 2009). The question then arises as to whether informal loan workouts are more advantageous to distressed companies than formalized and legislated rescue proceedings? Both Chatterjee, et al. (1996) and, more recently, Iverson (2004) suggest through their research that informal workouts offer certain

advantages or that companies opting for informal workouts tend to perform better post the workout of proceedings than companies opting for formal rescue processes.

Iverson (2004) goes on to say that the advantages of workouts are that they cost less than formal proceedings; news of the distress is kept to a minimum and the ability to work with key creditors informally all enhance the possibility of success. Chatterjee, et al. (1996) show through their research that opting for an informal workout, as opposed to Chapter 11 reorganization in the US, led to less adverse publicity and therefore better quality companies post the rescue proceedings.

In contrast and despite the many critics that a formal rescue procedure like Chapter 11 in the US has, there are also many that support the more formal procedure. Researchers such as Warren and Westbrook (2009) have suggested that the rescue of distressed companies is never an easy task, whether done by way of formal or informal proceedings, but that access to a formal procedure, such as Chapter 11, offers many businesses hope. More than just hope, these structured and formal proceedings also offer a framework in which these distressed companies can work within in order to possibly restructure their operations and capital structure and thereby attempt to rebuild their financial position.

Locally, Loubser (2010) suggests that informal workouts have certain disadvantages. She suggests that these disadvantages are issues such as the lack of protection that distressed companies have relative to creditors who are unwilling to support any informal workout turnaround and therefore these creditors may decide to attach the company's assets with the failure of the company almost guaranteed. She also suggests that informal workouts or rescues often have high costs. These costs, she contends, are the loss of equity to large creditors and the related loss of control of the business to

these creditors. Loubser also adds that the process of informal negotiations may be too cumbersome and lengthy to assist some businesses to succeed.

## **2.2 What is Business Rescue and how has it been used in South Africa in the past?**

With the financial crisis of the last few years there has been a greater focus on corporate recovery and insolvency, and the effects that these actions have on an economy. This is as much of an issue in South Africa as it is anywhere else and even more so considering the new Companies Act that redefines Business Rescue and how it is treated and the consequences that business failure has on communities, society and the economy in general.

Business rescue or turnaround has been described in many ways and can refer to both a formal process and an informal workout. Generally, the basic premise of business rescue is that it is a structured strategy that is implemented in companies in distress. It is typically a short term measure which usually utilizes drastic and radical changes or ownership restructuring in order to ensure survival of the distressed business in a changed business environment. It is seen as an efficient and immediate plan employed by the distressed company whose performance and cash flow is considered to be poor enough that without such measures there is a high likelihood of business failure in the near future (Marino, 2005).

The Companies Act (2008:230) defines business rescue as ‘proceedings to facilitate the rehabilitation of a company that is financially distressed. This ‘financially distressed’ term is an important term within the context of the new Act where it is given two explanations. Firstly, the term ‘financially distressed’ may relate to a company that appears to be ‘reasonably unlikely to be able to pay all of its debts as they fall due and payable within the immediately ensuing 6 months, and secondly, it appears reasonably likely that the company will become insolvent within the ensuing six months’. In terms of Chapter Six of this Act, Business Rescue is therefore meant to assist or

facilitate, under temporary measures, the rehabilitation of a financially distressed company (Bradstreet, 2010).

In the previous Companies Act (1976), there was no specific reference to Business Rescue, however, three formal procedures were available to companies in financial distress. These three procedures were a Scheme of Arrangement, Judicial management, and Liquidation (Oertel & Morgan, 2007). Liquidation proceedings were not meant as a business rescue option but rather as the formal means of winding a company up. However, both the Scheme of Arrangement and Judicial Management were formal procedures of corporate recovery.

The Scheme of Arrangement allowed a distressed company to enter into an arrangement between its creditors and itself and where this arrangement was a court sanctioned compromise. While Judicial Management, as a rescue procedure, was certainly closer to Business Rescue, as defined by the new Companies Act (2008), where a company that is unable to pay its debts and so likely to cease being a successful business, may be placed under Judicial Management and thereby survive and become successful again.

Judicial Management has clearly not succeeded as a turnaround strategy or business rescue procedure in South Africa. In fact, it has been long accepted by legal practitioners and liquidators operating in South Africa that this procedure just does not work within the South Africa context. Levenstein (2010: 6) states it clearly when he says that ‘quite simply, judicial management was a precursor for liquidation proceedings. This view is supported in spite of the fact that judicial management was accommodated in country’s first Companies of 1926’ (Loubser, 2010 and Bradstreet, 2010). However, despite there being rescue legislation available, a culture of rescue or corporate turnaround has not been developed. Loubser (2010: 3) provides much evidence for this and ultimately concludes that unfortunately “judicial

management has never been regarded as an effective rescue measure for companies in financial distress”.

This ambiguity, as evidenced internationally with well established procedures such as Chapter 11, as well as locally where there is little culture of rescue, lends support to a study that will attempt to understand whether the new legislation regarding business rescue will have an effect on distressed companies in South Africa.

## **2.2 International comparisons**

There are some countries that have laws and procedures for dealing with distress in companies, but there are also many countries that do not have a well developed system for assisting or even managing distress. With respect to the former group of countries and within their legal systems there is a strong realization that offering a legal procedure for rescuing or restructuring a distressed company has many potential benefits for the country involved.

Possibly the most well known of all international procedures is the Chapter 11 procedure in the United States (US), where there is a history and, as a result, a culture of rescue and reorganization that dates back over a hundred years (Lubben, 2010, and Pretorius & Holtzhausen, 2008). Other countries, such as Australia, Germany and England to name a few, have very similar procedures, where the objectives of the procedures are almost identical to that of South Africa's Business Rescue, but also with important differences. A brief review of some of the more well known international procedures can assist in providing insight into Business Rescue.

The goal of the Chapter 11 procedure in the US is very similar to Business Rescue in South Africa, which as Barron (2009) suggests is intended to give some space and time to distressed companies in order to reorganize, re-enter

the market place and hopefully be in a position to continue to perform and support jobs. Gaydosh (2008) and Barron (2009) both provide further explanation of Chapter 11 in that it is a procedure of business reorganization that allows the debtor in possession certain relief from its creditors, while still operating and, importantly, under supervision provided by the court.

The development of Chapter 11 in the US has proven to be very popular and has led to the development of similar procedures around the world, not least in South Africa, however with some important differences in certain cases. Further, its perceived success and expected benefits in the US has led to it being used far more often than the Chapter 7 procedure of liquidation, even when the applicant company is almost certainly destined for Chapter 7 or liquidation. This has been especially evident amongst the bigger corporations and this aspect of business rescue procedures is an important one when discussing the issues relating to South Africa's Chapter 6 in the next section (Warren & Westbrook, 2009 and Lubben, 2010). There is one major difference between the US's Chapter 11 and South Africa's Chapter 6 and that is the debtor in possession principle applied by the US's Chapter 11 procedure as opposed to South Africa's management displacement principle. Management displacement has been used by other countries and these principles will be discussed further in subsequent sections.

Anderson (2008), in his comparison of Australian and South African business rescue procedures, describes how the earliest form of the procedure used in Australia aimed at rescuing companies was the scheme of arrangement. This procedure was very similar to that used in South Africa and can be traced back to the English legal heritage that both countries share. At a later date when Australia updated its corporate rescue procedure, a form of insolvency administration was incorporated that was directly linked to the South African Judicial Management. This proved to be inadequate for large company distress and more recent amendments placed more emphasis on the need to maximize

the chances that a company in distress may have of surviving, or in other words, being rescued.

The Australian Corporations Act 2001 has very similar goals to South Africa's Business Rescue goals although certain aspects of the two regimes are different. Some of these similarities are the need for supervision during the rescue procedure and what form that supervision may take; meetings of creditors in both procedures; and the moratoriums needed to provide the distressed company and its administrator the time to formulate a rescue plan. As an example of a difference between the two procedures, there are no provisions in the Australian process for dealing with employees, whereas the South African Act provides employees with certain rights and protection not found elsewhere.

In England in the late 1970's when a major investigation and review of the country's insolvency laws was undertaken a report was published that recommended some major changes to the law, this report was called the Cork Report (1982). The Cork Report suggested that the country's laws until then had not been sufficiently geared to provide companies in distress with support as there was no formal procedure available to these companies. One of the major objectives of the report was to assist and encourage, where possible, the continuation of the business as opposed to the winding up and liquidation of the distressed business. This resulted in the recommendation that an administrator with certain powers be appointed and so the introduction of what could be considered as a formal business rescue procedure, not unlike South Africa's new Companies Act Chapter 6 and in contrast to the US' Chapter 11's debtor in possession philosophy.

Although this procedure was initially relatively successful, with a few high profile successes, it wasn't the success it was hoped it would be. Loubser (2010) suggests that one of the reasons for this was the costly report that



needed to be completed on the applicant company's affairs that was a part of any procedure as well as the costly and time consuming application to court for an administrator to be appointed. The Cork Report also recommended a voluntary workout procedure however this was also not as successful as hoped and the reason for this was the lack of provision for a moratorium on creditors enforcing their claims. Similarly, informal or voluntary workout in South Africa has the same disadvantage in that there is no formal procedure that allows a company protection against its creditors while negotiating a workout.

Germany started the process of reforming and redrafting its insolvency law in the late 1970's. Despite having the US's Chapter 11 as a major influence initially, when the law was finally legislated it had two major and important differences relative to Chapter 11. In the new German law the first difference is that the administrator is given wide ranging powers along the lines of management displacement which is different to the debtor in possession principal used in the US's Chapter 11. The second difference relates to the reorganization of businesses that are in distress in that the German law does not provide as much importance to reorganization of businesses that are in distress. Rather, the German law is largely based on insolvency proceedings whose main intention is to provide the best return possible to creditors, in many instances to the detriment of shareholders (Loubser, 2010).

However, the law's introduction of a plan to allow for reorganization and restructuring of a company's debts in order to assist with survival and ultimately rescue was based almost entirely on Chapter 11 (Loubser, 2010). Similarly to the new South African law the debtor or any of the company's creditors can apply to initiate insolvency proceedings; however, the new South African Act goes even further when it uses interested parties to include other stakeholder such as employees or their representatives for example.

## **2.3 Possible issues that may affect the use of the Business Rescue as opposed to an informal workout**

The new Companies Act (2008) has many aspects that are in line with international trends when considering business rescue. However, as with many international rescue proceedings, there are certain areas of the Act that may be a problematic issue for businesses or other stakeholders when considering applying for Business Rescue as contemplated in the Act, or when considering following a less formal route of workout. Some of these issues are discussed here.

### **2.3.1 Costs associated with Business Rescue**

Betker (1997) states that the direct cost of debt restructuring, or reorganization such as business rescue, ‘consist of the legal, accounting, and other professional fees and administrative costs’ involved in the procedure. Not least of these costs of using the Business Rescue process as laid out in Chapter 6 are the costs associated with the Business Rescue Practitioner. The Act provides for certain fees to be paid by the business while in Business Rescue proceedings and these costs, similarly to liquidator’s fees, are the first to be paid ahead of secured creditors. While there is widespread belief that a supervisor, or in this case a practitioner, is needed for the success of any formal rescue process (Harvey, 2011), the costs associated with such a position can be large. However, it is the indirect costs of a formalized process that are less known when a business considers this process.

Companies that enter business rescue may inadvertently bring upon themselves a negative perception purely through the act of applying for Business Rescue. This negative perception may lead to any rescue attempt failing even before it starts. Loubser (2010: 504) is explicit when she states that this may have ‘damaging consequences for a company: credit facilities and overdrafts will be canceled, suppliers will insist on being paid cash on delivery and creditors will demand immediate payment of their claims. As a result potential suppliers may request of the business conditions that are too onerous to be

sustainable or allow the business to recover and affect a successful turnaround. If the business rescue plan calls for the sale of any assets, there may be some difficulty achieving market related prices as any potential purchasers may know of the company's predicament and so offer lower bids and prices (Bris, Welch and Zhu, date).

Employees, under South African Business Rescue, will be a position of great strength as the Act is clear in stating that the company undergoing the procedure must ensure all employees are employed under the same terms and conditions as before (Companies Act, 2008). In fact, in Section 135(1) employees have further rights such as all payments due and payable by the company to its employees while the company is in business rescue will be classified as post-commencement finance.

Further, these claims will be granted ahead of any other post-commencement finance claims and only the costs of the procedure or the costs and remuneration of the Practitioner will precede these claims. Again, the objective is sound, where often the rights of employees are abused in liquidation where often very little or nothing is left for employees. However the reality is that employee costs are often the largest cost item of a company and one that is already in distress may be placed further in distress and rescue placed in jeopardy as a result of this cost burden.

### **2.3.2 Management displacement or debtor in possession**

The debtor in possession model is such that the existing management of the company remains in control of the company. The existing management then continues with managing the operations of the company while the reorganization procedure is put in place and throughout the following proceedings (Yamuchi, 2009). This is the model used in Chapter 11 reorganization in the US, while other countries such as Germany, Australia and the United Kingdom, and now, South Africa have opted for the

management displacement model. In contrast to debtor in possession, where management of the company remains as is, the model of management displacement is such that the operational management and property of the company is given to an independent practitioner to control for the time that the company is in the reorganization procedure. (Harvey, 2011)

In the new Companies Act the Practitioner has wide powers of control and according to the Act the Practitioner will have ‘full management control of the company in substitution for its board and pre-existing management’ (Companies Act S140, Bradstreet, 2010). The question that this brings out is to what extent is ‘substitution’ meant by the Act. Is it a full management displacement or will there be partial divestment by the management of the company. This is an important point as it relates to whether a company or a creditor is comfortable with the fact that management will, to a large degree, be displaced once the company has been placed in Business Rescue? Will the company, creditor or creditors be willing to work with the appointed Practitioner or will an interested party, as defined by the Act, look to replace this Practitioner?

### **2.3.3 Time frames and the rescue plan**

Research that has been undertaken in the US into companies that have entered Chapter 11 proceedings have suggested that some of these companies have used this procedure as a delaying tactic. Some companies that are not economically viable may be allowed to survive sub-optimally or to reorganize and exit only to have similar or worse performance after business rescue (Denis & Rodgers, 2007). The question, with regard to South African Business Rescue, is whether this will be seen to be the case here.

Chapter 6 of the new Companies Act 9 (2008) provides for a specific and well defined time frame for companies considering entering the Business Rescue process. These time frames seem to have been laid out to ensure that priority

and urgency is given to the process of, amongst other issues, appointing a Business Rescue Practitioner, first meeting of creditors, and presentation of the rescue plan. Criticism of the Chapter 11 process in the US has often been directed at the duration of this process (Denis & Rodgers, 2007, & Warren & Westbrook, 2009).

It has been argued that the length of the process can increase costs but also just as importantly the Chapter 11 procedure has been seen to protect companies from creditors and market forces. The process has, in certain cases, allowed for companies to enjoy too much time reorganizing or even to reorganize to such an extent that they exit from the process very different to what they entered. There is also the contention that many of these businesses would have been better off if they had been sold or even liquidated rather than the time and money spent reorganizing as the post Chapter 11 performance has, in many instances, been poor (Denis et al, 2007).

#### **2.3.4 Wide range of interested parties**

Unlike many other business rescue procedures around the world, Chapter 6 of the South African Companies Act (2008) provides accommodation for a wide range of interested parties; not least of these interested parties are the employees of the company. All employees of a company that is in distress and under Business Rescue will stay employed by the company and this employment will be under the same terms and conditions as what they enjoyed prior to the business being placed in Business Rescue (Section 136:1, Harvie: 2009).

While the idea of ensuring that all interested parties are provided with notices at each stage of the business rescue procedure is considered to be fair to all, the reality is that these repeated notifications could place too onerous a cost and administration burden on companies. In fact, Loubser (2010: 514) supports this when she clearly states that ‘the multiple and often quite

unnecessary notifications that have to be given to affected persons will add substantial costs to the procedure and could ultimately discourage its use’.

A further issue that should be raised is can a successful rescue be attained when considering all the interested parties’ needs that the Act specifies should be included in the process? A business rescue plan needs to be prepared by the Practitioner. According to the Act (Section 150[2]) ‘the business rescue plan must contain all the information reasonably required to facilitate affected persons in deciding whether or not to accept or reject the plan’. This requirement, especially in the case of larger or more complex businesses, may be out of the reach of many Practitioners especially considering the need to meet the relatively tight time frame of the procedure (Denis & Rodgers, 2007)

### **2.3.5 The Business Rescue Practitioner**

The Business Rescue procedure in South Africa’s new Companies Act has a heavy reliance on the Business Rescue Practitioner. The Act prescribes certain minimum qualifications that a potential Practitioner needs to comply with. For example and as per Section 138 of the Act this person must be a ‘member in good standing of a legal; accounting or business management profession accredited by the Commission; has been licensed as such by the Commission; does not have any other relationship with the company and is not related to a person who has a relationship contemplated in Section 138, paragraph (d). The Practitioner, according to the Act will assume full management control amongst other powers conferred by Section 140 as well as all the responsibilities, duties and liabilities of a director of the company; is responsible for the investigation of the affairs of the company, the business rescue plan, and implementation of the plan.

The reliance on the Practitioner in business rescue is such that many researchers and observers have suggested that the entire success of any rescue

procedure rests almost exclusively with the Practitioner. Levenstein (2010: 8) makes this clear when he says that ‘the key to successful turnarounds will be an ability on the part of the Practitioner to work with existing management and directors and to ultimately be successful in the turnaround of a financially distressed company’. Bradstreet (2010) agrees with this but also suggests that the entire procedure’s integrity may be under question when he suggests that ‘the functions and terms of appointment of such a Practitioner will be a pertinent consideration in assessing the merits of a corporate rescue regime’.

As a result, the skills and ability of the individual or individuals holding the office of the Practitioner will be of critical importance to all stakeholders when considering a business rescue procedure for a distressed company. A turnaround or rescue places huge pressure and strain on all parties and stakeholders, not least of all the Practitioner, and this pressure emphasizes the need for a skilled and proven Practitioner (Pretorius & Hotzhauzen, 2008). The Business Rescue Practitioner under Chapter 6 procedure will be provided with wide powers of control of the company and as Section 140(1) of the Act states ‘will have full management control of the company in substitution for its board and pre-existing management’.

The Practitioner must also, upon investigation of the company’s operations, affairs, property and financial situation provide an opinion of whether there is a reasonable prospect that the company can be rescued. Further the Practitioner also needs to be able to develop a realistic and feasible rescue plan that will be acceptable to a wide range of stakeholders ranging from employees, to creditors, both secured and unsecured and to equity holders. All of these actions must be done within a specified period of time. The skills that a Practitioner needs to be successful, and the responsibilities, duties and liabilities involved, are such that it is a question as to how many of these individuals are available in South Africa or even if there are such qualified individuals, how many will be interested in being a Practitioner.

### **Chapter 3: Data and Methodology**

This section explains the research design and the research methodology that will be applied to the research problem. The data and survey instruments of the study are informatively described in this chapter as well. This section also clarifies both the nature and the form of the results, then a separate chapter presents and discusses the results.

Within the section on the methodology of the study certain questions are developed, guided by the literature review, and that serve as the source of the data collection. Ethical considerations with regard to the study are explained and any limitations that the design and methodology may have are presented.

#### **3.1 Research design and methodology**

The research that is undertaken in this study involves the use of a questionnaire survey. There are, according to Leedy and Ormond (2005), five distinguishing characteristics that assist in designing the methodology of a research study, which are as follows: the purpose of the study, the process used in collection of data, analysis of the data and then the reporting of the findings. These characteristics can be used to provide support for a particular research design. These characteristics are expanded on below in the context of this study in order to provide support for the research design decision.

Recall that the purpose of the study is to investigate whether the newly legislated formal process of Business Rescue (Companies Act (2008) and Chapter 6: Business Rescue) will result in a fundamental change in culture when considering the rescue of businesses in distress. This fundamental change is related to the level of acceptance of a move to a more formal and structured procedure from the informal workouts that have been mainly in use up until now. As a result of the purpose being one of gauging perception the



technique of survey research is considered as best suited to this study and will accordingly be used.

The data collection involves the development of questions related to perceptions and views about the research purpose (Blaxter, Hughes & Tight, 2004). Survey research is the most commonly used method for descriptive research and Hofstee (2010: 122) observes that 'surveys can be an excellent way of finding out people's opinions, desires and attitudes'. It is the objective of this study to understand people's opinions on Business Rescue. Given that the research problem has not been studied before and that the legislation is new, primary data in the form of a survey is considered to be best suited to this study. As no past research has been done and as there is no clear idea as to how businesses, banks or other interested parties will use this new legislation, research of an informed sample's opinion is a good starting point for this study.

This survey research is based on specific questions, identified through the literature research, within a structured questionnaire. This questionnaire, based on quota sampling, was made available for online completion. A link to the online questionnaire is sent out by email to a specified sample of 'informed individuals' (Diamantopoulos & Schlegelmilch, 2005). This study identifies 'informed individuals' as those participants who have had some prior knowledge of the Companies Act (2008) so that their answers are meaningful and add relevance to this study. All questions are based on an ordinal scale except the first question. The first question is a yes/no, nominal scale type question which is used to identify those participants who have not had prior knowledge or exposure to the Act.

The questionnaire uses a 5 point Likert type scale in order to measure the opinions of the sample group. The 5 point Likert scale allows respondents to

indicate their level of agreement with a test statement on the 5 point scale as shown below:

- Strongly disagree
- Disagree
- Neither agree nor disagree
- Agree
- Strongly agree

The following statistical analyses are performed to analyze the results of the survey. As this is a descriptive survey, reliance is based on summary statistics that include frequency distributions and data visualization methods such as bar charts and pie charts to present the findings of the survey.

The responses given on each survey question are ordinal in nature. The Mann-Whitney test and the Kruskal-Wallis test are non-parametric tests that are suitable for ordinal data types such as those resulting from the Likert type questions in this survey. These hypothesis testing techniques are used to establish whether or not the differences in results obtained on each response item are statistically significant. Statistically significant opinions on the new scheme will therefore form the core findings of this research survey.

The following questions have been identified and they constitute the questionnaire:

**Table 1: Survey**

Question	Response				
	Very Poor	Poor	Fair	Good	Very Good
How would you rate your knowledge of the new Companies Act?					
Which of the following best describes your current status	Credit Provider e.g. Bank	Legal Profession	Potential or current Business Rescue or turnaround Practitioner	Director or shareholder of company	Interested party
South Africa does not have a culture of business rescue for distressed businesses	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
The newly legislated business rescue process is a welcome introduction	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
The newly legislated business rescue process is going to result in an increased adoption of business rescue processes by distressed companies in South Africa	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
Informal Loan workouts are more advantageous for distressed firms needing rescue than formal legislated rescue processes	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
Formal legislated rescue processes make it more difficult for a rescued business to maintain	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree

positive relations with creditors and suppliers					
Formal legislated rescue processes attract excessive negative attention and cause more reputational damage to rescued companies than informal loan workouts	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
Informal workout processes offer distressed companies too little protection from creditors that are unwilling to countenance a turnaround or rescue process	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
Informal workout processes are more likely to result in a loss of equity and or control to the rescued business' creditors	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
Formal legislated rescue processes as envisioned in Chapter 6 of the New Companies Act 2008 are excessively costly when compared to informal loan workouts	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
The possibility of total displacement of management by the business rescue practitioner in distressed companies is likely to significantly decrease the appeal of Chapter 6 of the New Companies Act for	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree

companies and their creditors					
The timeframe for Business Rescues processes by Chapter 6 of the New Companies Act provides sufficient urgency and is unlikely to result in abuse of the process	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
An excessive number of interested parties have been given rights by the Chapter 6 procedure	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
The rights afforded to employees of rescued companies by the Chapter 6 process are likely to make it impracticable to arrive at a feasible rescue plan	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
The design of the Chapter 6 process for business rescue makes the outcome of the process too reliant on the individual skills of the appointed business rescue practitioner	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
The level and mix of skills required in the potential business rescue practitioner are likely to make it difficult to find a sufficient number of qualified business rescue professionals in South Africa	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree

The questionnaires were disseminated to the various potential respondents by way of email. All of the respondents were contacted before the email was sent so as to ensure that they were aware of the questionnaire. The majority of the respondents were known to the researcher, either on a personal or professional basis, and as a result the response rate was very good with virtually no follow-up required.

The description of the survey outcome is presented in Chapter 4, and a summary of the responses provided through the survey are in the following format:

#### Demographics:

This includes a summary of the number of respondents to the questionnaire classified by occupation.

#### Descriptive Statistics:

The descriptive statistics are reproduced for ease of reference in a table form.

#### Question themes:

The questions have been separated into three unifying themes where the apparent perceptions and attendant policy guides resulting from these questions is discussed.

## Statistical Significance Tests

The statistical significance test ‘Chi-squared test for equal proportions’ is performed and an explanation of this test is provided below. The chi-squared test for equal proportions is a statistical test used to investigate whether the proportions of responses in each category are equal or whether there are statistically significant differences in the proportions of responses in each category. The relevant categories are the responses to the questionnaire which are split into the 5 point Likert Scale (Strongly Disagree, Disagree, Neither Agree nor disagree, Agree or Strongly Agree). The null hypothesis of the chi-square test is that the proportion of responses that fall into each of these categories is equal and any differences we observe are due to chance or random variation. If the null hypothesis is true, then we cannot conclude anything based on the responses we observe, as these are essentially due to chance. We reject this null hypothesis of equal proportions at the 5% significance level (95% confidence) if the p-value of the test for that question is less than or equal to 0.05. The p-value is shown as Pr> ChiSq in the output below. A p-value less than or equal to 0.05 indicates that the results obtained are statistically significant, indicating the dominant perception of respondents regarding the said question.

### **3.2 Limitations of the survey approach**

According to Burns (2000), the use of questionnaires has both advantages and disadvantages, which need to be recognized and, as best as possible, catered for in the design. The limitations discussed here are those relating to the research design and research methodology. Although great care has been taken to identify the best possible research design and research methodology, there will always be potential limitations depending on the type of design and methodology used. Due to the limited time frame and lack of resources available to the researcher, the sample size may not be considered ideal, but it is large enough to provide valid and reliable results.

While every effort has been made for this study to be as comprehensive as it can be with respect to the questions asked, it is the first study in South Africa, as far as the researcher is aware at time of writing. The researcher has attempted to identify past research in countries that have similar legislation for the research design's guide, however this turned out to be extremely difficult in terms of the work done at the onset of these laws. This above point was discussed further in the literature review, however this is a limitation in that there was little to base the questions on from past research or identify a methodology that was previously used.

### **3.3 Ethical considerations**

Due to the nature of the research design for this study, the potential for a breach in any ethical standard is highly unlikely. No direct contact with questionnaire participants was needed, thus no physical or psychological harm befell any person. No privacy rights were transgressed and all literature is properly referenced. All findings are completely reported, with no intentional misrepresentation of the findings of the study (Leedy and Ormond, 2006).

The researcher sent the questionnaire to the potential participants by e-mail and certain ethical considerations need to be considered. All emails sent had a covering note explaining the nature of the research, the researcher's contact details and all participation was purely offered by all participants in their own time and at their discretion. Participation was completely voluntary and ethical boundaries were not broken in this regard, particularly as participants responded anonymously.

This study also ensured that the intellectual property of others was completely respected at all times. Any use of another researcher's work is correctly and clearly shown. The referencing guidelines are prescribed by the Wits Business School (WBS) and are followed for all source material. While there is always



the potential for harm in any research study, all reasonable attempts have been made to avoid such in this study.

## Chapter 4: Results of Survey

This chapter provides results of the survey. The survey was an online one, consisting of 17 questions, and sent to 5 different occupation categories. It generated a total of 61 responses. The summary of responses to the survey is provided first; then a detailed analysis of these responses, grouped into unifying themes, is provided in the remainder of the chapter.

### 4.1 Summary of responses to the survey

The majority of the respondents to the survey (44.26%) were credit providers. The remaining respondents were legal professionals (19.67%), turnaround practitioners (18%), interested parties (11%) and directors of companies (7%). The survey included a sufficiently broad and representative sample of the parties involved in business rescue and turnaround processes.

**Table 2: Summary of responses:**

Which of the following best describes your current status?				
Response	Frequency	Percent	Cumulative Frequency	Cumulative Percent
Credit providers e.g. Bank	27	44.26	27	44.26
Director of shareholder of company	4	6.56	31	50.82
Interested party	7	11.48	38	62.30
Legal Profession	12	19.67	50	81.97
Potential or current Business Rescue or turnaround practitioner	11	18.03	61	100.00

### 4.2 Analysis of survey responses

An overall table showing granular responses from the survey is provided below:

**Table 3: Full survey response**

Questions	Frequency					Percent					Chi-Square Test		
	Vgood	Good	Fair	Poor	VPoor	Vgood	Good	Fair	Poor	VPoor	Chi-Sq	Deg Fr	P-Value
1 How would you rate your knowledge of the New Co. Act?	8	23	26	3	1	13.11	37.7	42.62	4.92	1	43.8361	4	<.0001
	Str. Agrd	Agrd	Neither	Disagr	Str Disgrd	Str. Agrd	Agrd	Neither	Disagr	Str Disgrd	Chi-Sq	Deg Fr	P-Value
2 South Africa doesn't have a culture of business rescue for distressed businesses?	8	27	6	16	4	13.11	44.26	9.84	26.23	6.56	29.2459	4	<.0001
3 The newly legislated business rescue process is a welcome introduction to business rescue in South Africa?	16	32	5	7	1	26.23	52.46	8.20	11.48	1.64	50.0656	4	<.0001
4 The newly legislated business rescue process is going to result in an increased adoption of business rescue processes by distressed companies in South Africa?	10	42	4	4	0	16.67	70.00	6.67	6.67	0.00	66.4	3	<.0001
5 Informal loan workouts are more advantageous for distressed firms needing rescue than formal legislated rescue processes?	8	20	15	17	0	13.33	33.33	25.00	28.33	0.00	5.2	3	0.1577
6 Formal legislated processes would make it more difficult for a rescued business to maintain positive relations with creditors and suppliers?	4	22	8	26	0	6.67	36.67	13.33	43.33	0.00	22.6667	3	<.0001
7 Formal legislated rescue processes would attract excessive negative attention and cause more reputational damage to rescued companies than	5	24	12	19	0	8.33	40.00	20.00	31.67	0.00	13.7333	3	0.0033
8 Informal workout processes offer distressed companies too little protection from creditors that are unwilling to countenance a turnaround or rescue process?	9	40	3	8	0	15.00	66.67	5.00	13.33	0.00	56.9333	3	<.0001
9 An excessive number of interested parties have been given rights by the Chapter 6 procedure?	2	28	11	16	2	3.39	47.46	18.64	27.12	3.39	40.0678	4	<.0001
10 The rights afforded to employees of rescued companies by the Chapter 6 processes are likely to make it impracticable to arrive at a feasible plan?	2	20	9	27	1	3.39	33.90	15.25	45.76	1.69	43.9661	4	<.0001
11 The design of the Chapter 6 process for business rescue makes the outcome of the process too reliant on the individual skills of the appointed business rescue practitioner?	14	29	6	10	0	23.73	49.15	10.17	16.95	0.00	20.5254	3	0.0001
12 The level and mix of skills required in the potential business rescue practitioner are likely to make it difficult to find a sufficient number of qualified business rescue professionals in South Africa?	16	24	7	12	0	27.12	40.68	11.86	20.34	0.00	10.4915	3	0.0148
13 Informal workout processes, as opposed to formal legislated processes, are more likely to result in a loss of equity and/or control to the rescued business' creditors?	3	18	15	21	2	5.08	30.51	25.42	35.59	3.39	26	4	<.00001
14 Formal legislated rescue processes as envisioned in Chapter 6 of the New Companies Act are excessively costly when compared to informal loan workouts?	10	29	9	10	1	16.95	49.15	15.25	16.95	1.69	36.1695	4	<.0001
15 The possibility of total displacement of management by the business rescue practitioner in distressed companies is likely to significantly decrease the appeal of Chapter 6 for companies and their creditors?	3	24	11	19	2	5.08	40.68	18.64	32.20	3.39	31.7627	4	<.0001
16 The timeframe for business rescue processes as envisioned in Chapter 6 provided sufficient urgency and is unlikely to result in abuse of the process?	2	33	8	12	4	3.39	55.93	13.56	20.34	6.78	52.6102	4	<.0001

The survey questions and the responses have been divided into four themes that will aid in the analysis of the survey questions. These four themes are: 1) questions relating to the new legislation; 2) questions relating to the costs, both direct and indirect, of the legislation, 3) questions related to the Business Rescue Practitioner and 4) questions related to the Business Rescue Plan. The four tables showing the different themes and the related questions are presented as Table 4, 5, 6 and 7. An appendix, Appendix A, is attached to the paper, providing tables, per theme, for the breakdown of responses per question for each of the different occupation categories. First, an explanation of the different themes is provided below.

#### 4.2.1. Questions related to the new legislation.

**Table 4: Questions related to the new legislation**

Theme 1: Questions related to the new legislation		Frequency					Percent					Chi-Square Test		
Questions		Str. Agr	Agrd	Neither	Disagr	Str Disgr	Str. Agr	Agrd	Neither	Disagr	Str Disgr	Chi-Sq	Deg Fr	P-Value
1	South Africa doesn't have a culture of business rescue for distressed businesses?	8	27	6	16	4	13.11	44.26	9.84	26.23	6.56	29.2459	4	<.0001
2	The newly legislated business rescue process is a welcome introduction to business rescue in South Africa?	16	32	5	7	1	26.23	52.46	8.20	11.48	1.64	50.0656	4	<.0001
3	The newly legislated business rescue process is going to result in an increased adoption of business rescue processes by distressed companies in South Africa?	10	42	4	4	0	16.67	70.00	6.67	6.67	0.00	66.4	3	<.0001
4	Informal loan workouts are more advantageous for distressed firms needing rescue than formal legislated rescue processes?	8	20	15	17	0	13.33	33.33	25.00	28.33	0.00	5.2	3	0.1577

These four questions are related both directly and indirectly to the new legislation. The first three questions in this theme are shown to be statistically significant, however the fourth question's p-value of the chi-square test is greater than 0.05. As a result the test cannot determine a statistically significant response to this question due to the high proportion of

responses received for each category of answers. This result, in itself, is of particular interest to this study in that there is no clear answer from the respondents as to whether the new legislated process will provide a benefit to distressed firms. This result is especially interesting in light of the very strong response to the second and third questions in this theme where as much as 78% and 87%, respectively, of the respondents either “Strongly Agreed” or “Agree” with the assertions that the ‘newly legislated business rescue process is a welcome introduction to business rescue in South Africa’ and that ‘this newly legislated process is going to result in an increased adoption of business rescue processes by distressed companies in South Africa’.

The apparent perceptions shown by this theme, irrespective of the result in the fourth question of this theme, seem to show that in spite of South Africa not having a culture of business rescue, a legislated process is both welcome and will likely see a strong response from distressed companies. As a result, the policy response to this should be that as much support as possible should be given to the legislated process in order to ensure a successful introduction of this process and to then develop and entrench a culture of business rescue for distressed companies.

The new process of Business Rescue is very different from the previous process and has been based on different processes seen around the world. It is of critical importance that the authorities understand that these international business rescue processes have been developed over time and in different cultures. This may result in a lot of uncertainty and possibly resistance or reluctance as the culture in South Africa to business rescue may not support this new process. As a result, the ability and confidence to amend the Act to more closely relate it to South Africa’s culture may be needed.

#### 4.2.2. Questions related to the costs, both direct and indirect, of the legislation.

**Table 5: Questions related to the costs, both direct and indirect, of the legislation**

Theme 2: Questions related to the costs, both direct and indirect, of the legislation		Frequency					Percent					Chi-Square Test		
Questions		Str. Agr	Agrd	Neither	Disag	Str Disg	Str. Agr	Agrd	Neither	Disag	Str Disg	Chi-Sq	Deg Fr	P-Value
1	Formal legislated processes would make it more difficult for a rescued business to maintain positive relations with creditors and suppliers?	4	22	8	26	0	6.67	36.67	13.33	43.33	0.00	22.6667	3	<.0001
2	Formal legislated rescue processes would attract excessive negative attention and cause more reputational damage to rescued	5	24	12	19	0	8.33	40.00	20.00	31.67	0.00	13.7333	3	0.0033
3	Informal workout processes offer distressed companies too little protection from creditors that are unwilling to countenance a turnaround or rescue process?	9	40	3	8	0	15.00	66.67	5.00	13.33	0.00	56.9333	3	<.0001
4	Informal workout processes, as opposed to formal legislated processes, are more likely to result in a loss of equity and/or control to the rescued business' creditors?	3	18	15	21	2	5.08	30.51	25.42	35.59	3.39	26	4	<.00001
5	Formal legislated rescue processes as envisioned in Chapter 6 of the New Companies Act are excessively costly when compared to informal loan workouts?	10	29	9	10	1	16.95	49.15	15.25	16.95	1.69	36.1695	4	<.0001

This theme's questions discussed the costs related to the legislation. These costs are both direct costs such as the costs of having to pay the Practitioner or a loss of equity as well as the indirect costs such as reputational loss to the business in question. All five questions in this theme were considered to be statistically significant.

The first question in this theme shows a lot of variability in the responses as well as the responses by occupation type. Directors of Companies agreed with this assertion by over 70% while the responses of legal professionals and credit providers had a majority disagreeing to the assertion. The variability in this response shows that there is a lot of uncertainty as to what will happen with respect to how a business that has followed this procedure will be able to maintain relations with its creditors and suppliers. No clear policy guideline can be provided in this case other than to suggest that policymakers keep a

close watch on developments and if it is found that rescued businesses are finding it difficult to maintain positive relations, then a change in the legislation to account for this needs to take place.

There are two questions in this theme where the results are of particular interest. These two questions are question 3 and 5 as shown in Theme 2's table and they stand out due to the very high percentage of 'Strongly Agreed' and 'Agreed' responses with 82% and 66% respectively. The other three questions also showed a strong tendency to 'Strongly Agreed' and 'Agreed' but with more variability, in particular questions 1 and 4 in the table for Theme 2.

The results from question 3 show that the perception, especially from Director's of Companies and Business Rescue or Turnaround Practitioners, is that informal workouts do not provide sufficient protection to companies from creditors. This is supported by the perception shown in Theme 1, that this legislation is welcomed as the formalized process will allow for a level of certainty. It is important for the authorities to closely monitor this aspect and to ensure that the protection from creditors is correctly balanced so as not to favour one side too much. For example, if too much protection is given to companies then credit providers may start looking to other ways to protect themselves and the unintended consequences may result in a further deterioration in relations between companies, their creditors and credit providers.

While the legislation is welcome, question 5's results do show that the perception of formal legislated processes as envisioned in "Chapter 6" are costlier than informal processes. If this result is taken in conjunction with the other questions in this theme, in particular questions 2 and 4, there is a very real perception that the legislation might be too costly for businesses to voluntarily apply for Business Rescue, unless desperate. The general evidence

internationally is that there is a cost involved for companies that follow a formal process of distress workout but that this cost, if managed correctly, can be considered worthwhile for many rescued companies. The perception in South Africa is that the formalized process of Business Rescue might well be overly costly and it is therefore imperative for the authorities to monitor this closely. If companies, or the relevant interested parties, believe that the formalized process is too costly then they will not consider this option and rather stay with the informal route. The challenge for the authorities is to ensure that a balance is achieved because reducing such costs “too much” that the Practitioner’s fees be considered inadequate for services provided which would invariably lead to the withdrawal of their vital expertise.

Taken individually, questions 2 and 4’s results are relatively variable with 32% on question 2 disagreeing and 39% on question 4 either disagreeing or strongly disagreeing. In both questions the occupations of the disagreeing respondents were well distributed, however, the overall perception seems to be broadly supportive of the view that the legislated process may well be too costly. As a result of this analysis a policy guideline that may be inferred is that the legislation might need to be amended to take into consideration this concern that the process of Business Rescue might be too costly for a business in distress. This is of particular importance given the fact that businesses in distress are by their very definition short of cash and so to be possibly burdened by these added costs may make the process of business rescue untenable.

It is important for the authorities administrating the law in South Africa to realize that constant monitoring of the costs, both direct and indirect, of Business Rescue is an important aspect of the ongoing success of the process. Factors that play a role in the economy are constantly changing and the law needs to evolve and be effectively monitored in order to keep up to date with these changing factors. If this is not done, the process may become obsolete in a way similar to the Judicial Management process of the old Act.



### 4.2.3. Questions related to the Business Rescue Practitioner

**Table 6: Questions related to the Business Rescue Practitioner**

Theme 3: Questions related to the Business Rescue Practitioner		Frequency					Percent					Chi-Square Test		
Questions		Str. Agr	Agrd	Neither	Disagr	Str Disg	Str. Agr	Agrd	Neither	Disagr	Str Disg	Chi-Sq	Deg Fr	P-Value
1	The design of the Chapter 6 process for business rescue makes the outcome of the process too reliant on the individual skills of the appointed business rescue practitioner?	14	29	6	10	0	23.73	49.15	10.17	16.95	0.00	20.5254	3	0.0001
2	The level and mix of skills required in the potential business rescue practitioner are likely to make it difficult to find a sufficient number of qualified business rescue professionals in South Africa?	16	24	7	12	0	27.12	40.68	11.86	20.34	0.00	10.4915	3	0.0148
3	The possibility of total displacement of management by the business rescue practitioner in distressed companies is likely to significantly decrease the appeal of Chapter 6 for companies and their creditors?	3	24	11	19	2	5.08	40.68	18.64	32.20	3.39	31.7627	4	<.0001

This theme discusses those questions related to the Business Rescue Practitioner. There are three questions in this theme and two of them, questions 1 and 2, show a particularly strong agreement to the two assertions as laid out in the questions. All three questions' results are statistically significant.

In the first question 73% of the respondent's indicate that they either agreed or strongly agreed that the Chapter 6 process for business rescue makes the outcome too reliant on the individual skills of the Practitioner. This was further supported by the results per occupation where each occupation category also showed a majority of respondents in each category agreeing or strongly agreeing. The second question also shows a majority of respondents agreeing or strongly agreeing that the level and mix of skills required in potential practitioners is likely to make it difficult to find a sufficient number of qualified business rescue professionals in South Africa. In this case over

80% of the Business Rescue or Turnaround Practitioners surveyed agreed and of that over 60% strongly agreed. This is an interesting response and supports the view that the level of skills needed could possibly result in a shortage of suitably qualified Practitioners.

There is a clear perception, based on the responses to these two questions, that the ability and choice of Practitioner will be an important factor in the success of any business rescue process. There is also a clear perception that there is likely to be a shortage of suitably qualified Practitioners. The policy response in both cases will be to ensure that, initially, suitably qualified Practitioners only should be allocated to Business Rescue applicants and that ongoing assessment as well as training and development of the desired quality of practitioners is undertaken.

The third question relates to the displacement of management by the Practitioner and although a large portion of respondents, 46%, agreed or strongly agreed there was also a relatively large portion of respondents that disagreed and strongly disagreed, 36%. It is interesting to note that 50% or more of credit providers and directors of companies agreed while over 40% of legal professionals and business rescue or turnaround practitioners disagreed. The variability in this question's results again shows the uncertainty of how the new legislation will practically work. It will be very important to the success of this Act that the Practitioners that are appointed have the correct skill sets and are seen to be successful. If the business community and other interested parties, as defined by the Act, perceive this aspect to be a failure then it is likely that the Business Rescue process may be consigned to the same fate as that of the previous Act's Judicial Management: irrelevant and rarely, if ever, used.

#### 4.2.4 Questions related to the Business Rescue Plan

**Table 7: Questions related to the Business Rescue Plan**

Theme 4: Questions related to the Business Rescue Plan						Frequency					Percent					Chi-Square Test		
Questions						Str. Agri	Agri	Neither	Disagri	Str Disgr	Str. Agri	Agri	Neither	Disagrd	Str Disg	Chi-Sq	Deg Fr	P-Value
1	An excessive number of interested parties have been given rights by the Chapter 6 procedure?					2	28	11	16	2	3.39	47.46	18.64	27.12	3.39	40.0678	4	<.0001
2	The rights afforded to employees of rescued companies by the Chapter 6 processes are likely to make it impracticable to arrive at a feasible plan?					2	20	9	27	1	3.39	33.90	15.25	45.76	1.69	43.9661	4	<.0001
3	The timeframe for business rescue processes as envisioned in Chapter 6 provides sufficient urgency and is unlikely to result in abuse of the process?					2	33	8	12	4	3.39	55.93	13.56	20.34	6.78	52.6102	4	<.0001

This theme discusses those questions related to the Business Rescue Practitioner. There are three questions in this theme and again two of these, questions 1 and 3, show a majority of respondents either strongly agreeing or agreeing to the two assertions in the questions. The third question, question 2, shows more variability in the responses, with as many as 47% of the respondents either disagreeing or strongly disagreeing. All three questions' results are statistically significant.

The first two questions in this theme relate to the rights given to interested parties and although the first question's results show a majority of respondents agreeing, both sets of results are relatively variable. This is supported by the results of the different occupation categories where only in the first question's results is there a clear majority response. This is for the legal professionals who agreed by over 70% with the assertion, with the balance disagreeing and none of the legal professional respondents neither agreeing nor disagreeing. It is clear from these results that the new legislation is introducing something new to the industry and that the industry players are uncertain how this will take effect. Again, this is due to the fact that the Business Rescue process in South Africa is new and untested. It is important for the authorities to accept that this new process may need amendments to

ensure that it is relevant to South African circumstances and that these amendments are made when needed and after due consideration of all relevant parties.

The third question with respect to the plan asks whether the plan provides for sufficient urgency and guards against abuse of the process. In this case the results show that 60% of all respondents agreed or strongly agreed. This is supported by the results shown per occupation category with, in particular, every 'director of company' respondent either agreeing or strongly agreeing. One of the potential areas for abuse in the South African Business Rescue process is that many different interested parties are allowed to file for Business Rescue proceedings. A possible policy guide would be to assess whether this abuse is taking place and if so a solution to this would be to follow the German example and only allow debtors to file for Business Rescue proceedings.

## **Chapter 5: Conclusion**

The New Companies Act (2008) has now been in place for a year, at the time of writing, with many companies having taken up the option of Business Rescue. Many lessons have been learnt and certain perceptions are either being changed or developed. As a result, this paper is important because it has researched some of these perceptions. This Chapter provides a summary of findings; provides the paper's conclusions and suggests possibilities for further research.

### **5.1 Summary of Findings**

The survey's questions were divided into four unifying themes in order to more clearly understand the results and responses of the survey. All the questions except one were shown to be statistically significant and even the question that was not statistically does provide some useful insight.

The first unifying theme combined questions related to the new legislation and the findings here clearly show that the new legislation is welcome and there is likely to be a strong adoption of this process by companies, in spite of an undeveloped culture of business rescue in South Africa. As a result of this it will be important to develop this culture by way of providing support through efficient infrastructure such as properly functioning courts and legal processes, and effective training and communication. It is interesting to note that the final question in this theme had a p-value greater than 0.05. This question is also very closely related to the title of this thesis and so this result stands out and clearly shows how much uncertainty there is around this new legislation, in spite of the perceived need for the legislation.

The next theme discussed the costs related to the new legislation and while there is a certain amount of variability in the responses, possibly expressing

the uncertainty of the new legislation by the respondents, the responses collectively inferred some concern over the potential costs of this legislation. What can be found from this is that if these costs are found to be prohibitive the formalized process may not be considered as a viable option and the authorities need to monitor this closely to ensure that the correct balance is struck (if need be, via amendment of the cost aspect of Chapter 6).

The third theme considered the questions related to the Practitioner and the responses showed a lot less variability and a very strong emphasis on the importance that the Practitioner will play in this legislation. As a result of this it will be important to identify strong practitioners initially to ensure that belief in the process is engendered as well as the possibility of successful business rescue attempts. Without this belief in the practitioner and good early successes the public perception of business rescue may not develop in such a way that Business Rescue is seen as positive and so result in a constructive Business Rescue culture in the country.

The final theme was that of the questions related to the Business Rescue Plan and in this case there was less variability in the first two questions, where there was a majority of respondents in agreement, while the third question did provide some variability. From these findings it seems that the legislation has provided for sufficient support to the Business Rescue Plan. It has been found in other parts of the world with similar legislation that rescue proceedings have been used as delaying tactics and that either the length of time provided for a plan to be drafted or the number of parties included can be excessively onerous on the distressed company or its creditors. Based on the responses to the questions in this paper this does not seem to be case here.

## **5.2 Conclusions**

The New Companies Act's (2008) Chapter Six: Business Rescue is clearly a very welcome and much needed addition to company law in South Africa.

However there does seem to be much uncertainty with regard to this legislation and what it will mean in practice. One of the reasons for this uncertainty is the lack of a developed and strong culture of business rescue for distressed businesses in South Africa and this is clearly evident in the uncertainty expressed in the response to many of the questions asked in the survey.

It is also plausible to infer, from the level of uncertainty shown in the results and from the findings that it is uncertain as to whether informal loan workouts will no longer be needed. While the results do highlight the need for new legislation around business rescue the uncertainty shown in the result may see informal loan workouts remaining as a very real option for many businesses. What is important is that the authorities keep a close watch on the developments related to Business Rescue and ensure that, where possible, adjustments or amendments are made. This is imperative to ensuring the success of the new legislation and engendering a Business Rescue culture. Failure to do this will likely see affected parties revert back to informal proceedings, which is a path from which this legislation is attempting to depart.

### **5.3 Suggestions for Further Research**

The Business Rescue process in South Africa is new and untested and as a result there will be numerous opportunities for further research to be conducted. However, based on the findings of this paper certain important issues are raised and point to the possibilities for further research.

The most obvious possibility for further research is how the perception of business rescue in South Africa has changed since the introduction of this new legislation and whether there is now a greater cultural awareness of business rescue and the need for business rescue in South Africa. Added to this is the possibility of researching whether the goals of the new legislation have been

achieved, such as whether the formal process has been a success at rescuing businesses and saving jobs.

The initial uncertainty of many of the responses can also lead to areas of possible further research. For example, the uncertainty around whether the formalized processes will make it difficult for a rescued business to maintain positive relations with creditors and suppliers, whether businesses that have undergone the formalized process have lost equity or control to its creditors and what affect have the wide range of interested parties had on business rescue proceedings.

These are just a few of the possibilities for further research based on this paper. Many other areas for further research may still present themselves as time goes on and as other works are done.



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## Appendix A: Responses by occupation category

### Theme 1: Questions related to the new legislation

Which of the following best describes your current status?	South Africa does not have a culture of business rescue for distressed businesses?					
Frequency Percent	a: Strongly Agree	b: Agree	c: Neither agree nor disagree	d: Disagree	e: Strongly disagree	Total
Credit provider e.g. Bank	0 0.00	11 18.03	4 6.56	10 16.39	2 3.28	27 44.26
Director of shareholder of company	0 0.00	3 4.92	1 1.64	0 0.00	0 0.00	4 6.56
Interested party	0 0.00	4 6.56	1 1.64	1 1.64	1 1.64	7 11.48
Legal Profession	2 3.28	5 8.20	0 0.00	4 6.56	1 1.64	12 19.67
Potential or current Business Rescue or turnaround professional	6 9.84	4 6.56	0 0.00	1 1.64	0 0.00	11 18.03
Total	8 13.11	27 44.26	6 9.84	16 26.23	4 6.56	61 100.00

Which of the following best describes your current status?	The newly legislated business rescue process is a welcome introduction to business rescue in South Africa?					
Frequency Percent	a: Strongly Agree	b: Agree	c: Neither agree nor disagree	d: Disagree	e: Strongly disagree	Total
Credit provider e.g. Bank	2 3.28	18 29.51	3 4.92	3 4.92	1 1.64	27 44.26
Director of shareholder of company	1 1.64	3 4.92	0 0.00	0 0.00	0 0.00	4 6.56
Interested party	1 1.64	4 6.56	0 0.00	2 3.28	0 0.00	7 11.48
Legal Profession	4 6.56	4 6.56	2 3.28	2 3.28	0 0.00	12 19.67
Potential or current Business Rescue or turnaround professional	8 13.11	3 4.92	0 0.00	0 0.00	0 0.00	11 18.03
Total	16 26.23	32 52.46	5 8.20	7 11.48	1 1.64	61 100.00

Which of the following best describes your current status?	The newly legislated business rescue process is going to result in an increased adoption of business rescue processes by distressed companies in South Africa?				
Frequency Percent	a: Strongly Agree	b: Agree	c: Neither agree nor disagree	d: Disagree	Total
Credit provider e.g. Bank	3 5.00	20 33.33	1 1.67	3 5.00	27 45.00
Director of shareholder of company	1 1.67	3 5.00	0 0.00	0 0.00	4 6.67
Interested party	0 0.00	4 6.67	1 1.67	1 1.67	6 10.00
Legal Profession	4 6.67	7 11.67	1 1.67	0 0.00	12 20.00
Potential or current Business Rescue or turnaround professional	2 3.33	8 13.33	1 1.67	0 0.00	11 18.33
Total	10 16.67	42 70.00	4 6.67	4 6.67	60 100.00

Which of the following best describes your current status?	Informal loan workouts are more advantageous for distressed firms needing rescue than formal legislated rescue processes?				
Frequency Percent	a: Strongly Agree	b: Agree	c: Neither agree nor disagree	d: Disagree	Total
Credit provider e.g. Bank	4 6.67	10 16.67	6 10.00	7 11.67	27 45.00
Director of shareholder of company	0 0.00	3 5.00	1 1.67	0 0.00	4 6.67
Interested party	1 1.67	1 1.67	2 3.33	2 3.33	6 10.00
Legal Profession	1 1.67	3 5.00	3 5.00	5 8.33	12 20.00
Potential or current Business Rescue or turnaround p	2 3.33	3 5.00	3 5.00	3 5.00	11 18.33
Total	8 13.33	20 33.33	15 25.00	17 28.33	60 100.00

**Theme 2: Questions related to the costs, both direct and indirect, of the legislation**

Which of the following best describes your current status?	Formal legislated rescue processes would make it more difficult for a rescued business to maintain positive relations with creditors and suppliers				
Frequency Percent	a: Strongly Agree	b: Agree	c: Neither agree nor disagree	d: Disagree	Total
Credit provider e.g. Bank	1 1.67	10 16.67	2 3.22	14 23.33	27 45.00
Director of shareholder of company	0 0.00	3 5.00	1 1.67	0 0.00	4 6.67
Interested party	1 1.67	2 3.33	1 1.67	2 3.33	6 10.00
Legal Profession	1 1.67	3 5.00	2 3.33	6 10.00	11 18.33
Potential or current Business Rescue or turnaround p	1 1.67	4 6.67	2 3.33	4 6.67	11 18.33
Total	4 6.67	22 36.67	8 13.33	26 43.33	60 100.00



Which of the following best describes your current status?	Formal legislated rescue processes would attract excessive negative attention and cause more reputational damage to rescued companies than informal loan workouts?				
Frequency Percent	a: Strongly Agree	b: Agree	c: Neither agree nor disagree	d: Disagree	Total
Credit provider e.g. Bank	2 3.33	9 15.00	6 10.00	10 16.67	27 45.00
Director of shareholder of company	0 0.00	2 3.33	0 0.00	2 3.33	4 6.67
Interested party	1 1.67	3 5.00	0 0.00	2 3.33	6 10.00
Legal Profession	1 1.67	4 6.67	3 5.00	4 6.67	12 20.00
Potential or current Business Rescue or turnaround p	1 1.67	6 10.00	3 5.00	1 1.67	11 18.33
Total	5 8.33	24 40.00	12 20.00	19 31.67	60 100.00

Which of the following best describes your current status?	Informal workout processes offer distressed companies too little protection from creditors that are unwilling to countenance a turnaround or rescue process?				
Frequency Percent	a: Strongly Agree	b: Agree	c: Neither agree nor disagree	d: Disagr ee	Total
Credit provider e.g. Bank	4 6.67	17 28.33	2 3.33	4 6.67	27 45.00
Director of shareholder of company	0 0.00	4 6.67	0 0.00	0 0.00	4 6.67
Interested party	0 0.00	5 8.33	0 0.00	1 1.67	6 10.00
Legal Profession	0 0.00	9 15.00	1 1.67	2 3.33	12 20.00
Potential or current Business Rescue or turnaround professional	5 8.33	5 8.33	0 0.00	1 1.67	11 18.33
Total	9 15.00	40 66.67	3 5.00	8 13.33	60 100.00

Which of the following best describes your current status?	Formal legislated rescue processes as envisioned in Chapter 6 of the New Companies Act are excessively costly when compared to informal loan workouts?					
Frequency Percent	a: Strongly Agree	b: Agree	c: Neither agree nor disagree	d: Disagree	e: Strongly disagree	Total
Credit provider e.g. Bank	7 11.86	14 23.73	3 5.08	1 1.69	1 1.69	26 44.07
Director of shareholder of company	0 0.00	2 3.39	0 0.00	2 3.39	0 0.00	4 6.78
Interested party	1 1.69	2 3.39	3 5.08	0 0.00	0 0.00	6 10.17
Legal Profession	2 3.39	7 11.86	1 1.69	2 3.39	0 0.00	12 20.34
Potential or current Business Rescue or turnaround p	0 0.00	4 6.78	2 3.39	5 8.47	0 0.00	11 18.64
Total	10 16.95	29 49.15	9 15.25	10 16.95	1 1.69	59 100.00

### Theme 3: Questions related to the Business Rescue Practitioner

Which of the following best describes your current status?	Formal legislated rescue processes as envisioned in Chapter 6 of the New Companies Act are excessively costly when compared to informal loan workouts?					
Frequency Percent	a: Strongly Agree	b: Agree	c: Neither agree nor disagree	d: Disagree	e: Strongly disagree	Total
Credit provider e.g. Bank	7 11.86	14 23.73	3 5.08	1 1.69	1 1.69	26 44.07
Director of shareholder of company	0 0.00	2 3.39	0 0.00	2 3.39	0 0.00	4 6.78
Interested party	1 1.69	2 3.39	3 5.08	0 0.00	0 0.00	6 10.17
Legal Profession	2 3.39	7 11.86	1 1.69	2 3.39	0 0.00	12 20.34
Potential or current Business Rescue or turnaround p	0 0.00	4 6.78	2 3.39	5 8.47	0 0.00	11 18.64
Total	10 16.95	29 49.15	9 15.25	10 16.95	1 1.69	59 100.00

Which of the following best describes your current status?	Formal legislated rescue processes as envisioned in Chapter 6 of the New Companies Act are excessively costly when compared to informal loan workouts?					
Frequency Percent	a: Strongly Agree	b: Agree	c: Neither agree nor disagree	d: Disagree	e: Strongly disagree	Total
Credit provider e.g. Bank	7 11.86	14 23.73	3 5.08	1 1.69	1 1.69	26 44.07
Director of shareholder of company	0 0.00	2 3.39	0 0.00	2 3.39	0 0.00	4 6.78
Interested party	1 1.69	2 3.39	3 5.08	0 0.00	0 0.00	6 10.17
Legal Profession	2 3.39	7 11.86	1 1.69	2 3.39	0 0.00	12 20.34
Potential or current Business Rescue or turnaround p	0 0.00	4 6.78	2 3.39	5 8.47	0 0.00	11 18.64
Total	10 16.95	29 49.15	9 15.25	10 16.95	1 1.69	59 100.00

Which of the following best describes your current status?	The possibility of total displacement of management by the business rescue practitioner in distressed companies is likely to significantly decrease the appeal of Chapter 6 for companies and their creditors?					
Frequency Percent	a: Strongly Agree	b: Agree	c: Neither agree nor disagree	d: Disagree	e: Strongly disagree	Total
Credit provider e.g. Bank	0 0.00	14 23.73	5 8.47	6 10.17	1 1.69	26 44.07
Director of shareholder of company	0 0.00	2 3.39	1 1.69	1 1.69	0 0.00	4 6.78
Interested party	1 1.69	2 3.39	1 1.69	2 3.39	0 0.00	6 10.17
Legal Profession	2 3.39	3 5.08	2 3.39	5 8.47	0 0.00	12 20.34
Potential or current Business Rescue or turnaround p	0 0.00	3 5.08	2 3.39	5 8.47	1 1.69	11 18.64
Total	3 5.08	24 40.68	11 18.64	19 32.20	2 3.39	59 100.00

#### Theme 4: Questions related to the Business Rescue Plan

Which of the following best describes your current status?	The possibility of total displacement of management by the business rescue practitioner in distressed companies is likely to significantly decrease the appeal of Chapter 6 for companies and their creditors?					
Frequency Percent	a: Strongly Agree	b: Agree	c: Neither agree nor disagree	d: Disagree	e: Strongly disagree	Total
Credit provider e.g. Bank	0 0.00	14 23.73	5 8.47	6 10.17	1 1.69	26 44.07
Director of shareholder of company	0 0.00	2 3.39	1 1.69	1 1.69	0 0.00	4 6.78
Interested party	1 1.69	2 3.39	1 1.69	2 3.39	0 0.00	6 10.17
Legal Profession	2 3.39	3 5.08	2 3.39	5 8.47	0 0.00	12 20.34
Potential or current Business Rescue or turnaround p	0 0.00	3 5.08	2 3.39	5 8.47	1 1.69	11 18.64
Total	3 5.08	24 40.68	11 18.64	19 32.20	2 3.39	59 100.00

Which of the following best describes your current status?	The possibility of total displacement of management by the business rescue practitioner in distressed companies is likely to significantly decrease the appeal of Chapter 6 for companies and their creditors?					
Frequency Percent	a: Strongly Agree	b: Agree	c: Neither agree nor disagree	d: Disagree	e: Strongly disagree	Total
Credit provider e.g. Bank	0 0.00	14 23.73	5 8.47	6 10.17	1 1.69	26 44.07
Director of shareholder of company	0 0.00	2 3.39	1 1.69	1 1.69	0 0.00	4 6.78
Interested party	1 1.69	2 3.39	1 1.69	2 3.39	0 0.00	6 10.17
Legal Profession	2 3.39	3 5.08	2 3.39	5 8.47	0 0.00	12 20.34
Potential or current Business Rescue or turnaround p	0 0.00	3 5.08	2 3.39	5 8.47	1 1.69	11 18.64
Total	3 5.08	24 40.68	11 18.64	19 32.20	2 3.39	59 100.00



Which of the following best describes your current status?	The possibility of total displacement of management by the business rescue practitioner in distressed companies is likely to significantly decrease the appeal of Chapter 6 for companies and their creditors?					
Frequency Percent	a: Strongly Agree	b: Agree	c: Neither agree nor disagree	d: Disagree	e: Strongly disagree	Total
Credit provider e.g. Bank	0 0.00	14 23.73	5 8.47	6 10.17	1 1.69	26 44.07
Director of shareholder of company	0 0.00	2 3.39	1 1.69	1 1.69	0 0.00	4 6.78
Interested party	1 1.69	2 3.39	1 1.69	2 3.39	0 0.00	6 10.17
Legal Profession	2 3.39	3 5.08	2 3.39	5 8.47	0 0.00	12 20.34
Potential or current Business Rescue or turnaround p	0 0.00	3 5.08	2 3.39	5 8.47	1 1.69	11 18.64
Total	3 5.08	24 40.68	11 18.64	19 32.20	2 3.39	59 100.00