Is restoring a financially distressed company to solvency achievable?

By Dr Eric Levenstein

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With continued load shedding, a logistics crisis at our ports costing the South African economy R100m per day, and with rampant consumer inflation (reported to now be at 5.9% in October 2023), South African companies are now facing increasing pressure to trade profitably, going into what has always been a busy December festive season.

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Come January next year, and when the dust has settled on 2023, we are no doubt going to see companies having to deal with financial distress and where some might have to consider the intervention of a business rescue process. South African corporates are in for a tough time in 2024. Stats SA recently reported that just over 1,376 companies have closed their doors in 2023, with 136 companies filing for liquidation in October alone.

Enter business rescue

An alternative to having to file for liquidation, is the commencement of business rescue proceedings as provided for in the 2008 Companies Act. A business rescue practitioner would be appointed to supervise the company through its business rescue process and hopefully where a business rescue plan is approved by creditors and other stakeholders, allowing the company to be rescued from the brink of collapse.

When one takes a look at the outcomes of business rescue mandates in the last decade, the vast majority of business rescues in South Africa have focused on the wind down of a company in business rescue, as opposed to the implementation of a rescue plan which allows a struggling company to trade out of its financial distress intact, having been operationally restructured and where the company is returned into the South African economy on a restructured and solvent basis.

After all, providing a struggling company with the opportunity for a fresh start, with its debt having been compromised and its operations (ie. affairs business and property) having been properly restructured, must have been the intention of government when they introduced Chapter 6 (business rescue) into the 2008 Companies Act.

Third party involvement

The business rescue of companies such as Group 5, Basil Read, Edcon, The New House of Busby, Stuttafords and others, all ended up with a portion of its business and/or assets being sold to third parties and where the business rescue practitioner managed to deliver a better dividend to creditors in its business rescue process as compared to what would have been achieved if the company had been placed into immediate liquidation. The company's life would however come to an end with a break up of businesses and assets having taken place. The company would be left with nothing but an empty shell and where it would be placed into liquidation or deregistered.

Section 128(1)(b) of the 2008 Companies Act refers to the "wind down" option as being one possible outcome of a business rescue process, but unfortunately the alternative of the restoration of the company to solvency, seems to have been left behind. After all, the definition of business rescue talks to the rehabilitation of companies under a rescue process, not a wind down.

However, the stated objectives of business rescue provides that if the company cannot be rehabilitated, then the creditors must at least receive a higher dividend than in liquidation (referred to as a Part B rescue)- although the latter course of action does appear to have become the norm.

This question was raised by delegates attending the South African Restructuring and Insolvency Practitioners Association (Saripa) conference held at Sun City at the beginning of November. Practitioners debated the issue and where discussion revolved around how the restructuring profession can work towards bolstering the alternative of a solvent restructuring in the South African business rescue space.

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Timing

Clearly a determinative factor in deciding whether an operational restructuring, as opposed to a wind down under Part B, will be the timing of when the company goes into business rescue. The issue will be whether the company is already too far gone down its distressed pathway, so that the only alternative remaining is to wind it down by selling off the company's assets, subsidiaries, businesses to third party buyers.

If directors leave it too late, and only file for business rescue when the company is already severely financially distressed, then the chances of being successful with a operational restructuring becomes limited. The key is of course to get in early, and appoint a practitioner to supervise the company and its business in its distressed period, and then work towards its exit on a solvent basis with the support of stakeholders and creditors. This allows the "business" to be rescued and where the vast majority of jobs will be retained.

Appropriately skilled practitioners

Another key factor will be the ability of the appointed business rescue practitioner to have the requisite skill set to achieve both an operational restructuring as well as a financial restructuring in the process. A business rescue plan would have to cater for the compromise of existing debt, and the renegotiation of prejudicial contracts such as supply contracts that are not on favorable terms or expensive lease arrangements that might need to be renegotiated. Take Edcon as an example - in September 2020 Edgars was sold to Retailability out of business rescue and where the practitioner was able to terminate unprofitable leases, allowing the company to continue to trade with a much smaller footprint across South Africa.

Further, the practitioner might have to reduce the size of the workforce, attend to retrenchments and renegotiate loan facilities with the company's bankers. All with the ultimate goal of having the plan supported by 75% of creditors voting in favour of the plan. Once approved, the creditors would leave it to the practitioner to implement the rescue plan, and then discharge the company from its business rescue process.

The company would then be returned into the market on a solvent basis ready to continue trading with its suppliers and customers. A far better outcome than a break-up of the company by way of an ad hoc disposal of its assets and businesses in a wind down scenario.

Key staff retention

Of concern to a business rescue practitioner in an operational restructuring will be the level of cooperation of the remaining management skills that can assist in restructuring the company once the company has entered the business rescue process. It is important for the practitioner to retain key employees to work together with the practitioner in dealing with irate creditors, suppliers whose debt might have to be compromised and, importantly, to get all stakeholders on side and get them to collaborate with the practitioner in achieving a successful turnaround for the company.

The crucial skill set is the ability to deal with people, a skill often forgotten in the often stressful environment of business rescue.

In order to see more operational business rescues in South Africa, South African boards of directors will need to stop focusing only on the protective moratorium (stay on claims) provided by statute in the business rescue process, and rather focus their energies on saving the company through an operational restructuring, and returning the company to trading on a solvent basis, with its business, employees and customers and supply contracts in place.

This will achieve a reduction in the number of corporate failures in South Africa.

ABOUT THE AUTHOR

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