How the business rescue process works

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Are you or your clients facing business collapse? The South African Institute of Chartered Accountants (Saica) explores practical options relating to the business rescue process and turnaround interventions.

While the South African government is doing everything it can to assist struggling businesses in the wake of the coronavirus, the harsh reality is that many SMEs will take a huge knock in the coming months. This will come either directly as a result of shutdowns and restrictions, or indirectly as a result of the struggling global economy.

Early intervention is key to ensuring the best outcome for companies in distress. Unfortunately, many business owners simply don’t know where to turn when they find themselves in difficulty.

Ian Fleming of Engaged Business Turnaround

Peter Cameron Gordon of Crest Capital

As part of Saica's *Leadership in a Time of Crisis* webinar series, Peter Cameron Gordon of Crest Capital and Ian Fleming of Engaged Business Turnaround, both CAs(SA), licensed business rescue practitioners and members of the Turnaround Management Association, give insight to the business rescue process. Gordon and Fleming have recently joined forces with IQ Business and Schindlers Attorneys to form Cobra, or Covid Business Rescue Assistance, a largely pro bono initiative that brings together various experts to create a marketplace of huge skills to help businesses in distress.

Selecting a business rescue practitioner

Gordon and Fleming advise that the following key pillars are important when selecting a business rescue practitioner:

1. **Trust.** There needs to be trust between the business rescue practitioner, the distressed company, the creditors, banks, government, Sars and other stakeholders, because if there isn't trust then the process can become chaotic.
2. **Collaboration.** Business rescue should never be an acrimonious process. Collaboration and communication with all stakeholders - suppliers, shareholders, directors, staff and government is critical at a time like this.
3. **Flexibility.** Bear in mind that even though a business may be in rescue, the owner and the practitioner have to be prepared to change the plan when necessary. Business plans are always fluid and need to be adapted, and business rescue is no different. Owners have to be prepared to make changes as the process progresses.
4. **Affordability.** This is especially important for small businesses in the current climate.
5. **Speed.** One of the criticisms of the business rescue process is it sometimes drags on and on, which can be detrimental to creditors. Turnarounds, both formal and informal, must be done as quickly as possible.

Business rescue 101

Business rescue is outlined in chapter six of the Companies Act. First and foremost, its aim is to provide the distressed company time in order to realign its business so as to return to a financially viable position or to provide the creditors with a better return than would be the case in a liquidation. This is achieved by providing the company with a moratorium against any legal action against the company. “This doesn’t only refer to creditors’ claims against the company, but any legal application,” says Fleming. “It is an absolute steel jacket, and the purpose is to give the company the breathing space to sort out its affairs under the guidance of a business rescue practitioner.”

Fleming goes on to explain that the directors need to pass a resolution to place the company in business rescue. “In addition to the directors resolving to do so, any affected person (shareholders, creditors and labour unions/staff) can apply to the court to place the company into business rescue,” he says, while explaining that the easiest route is a directors’ resolution. “At least 50% plus one of the directors need to agree and, once this is the case, the resolution is passed,” says Fleming.

The resolution together with a sworn affidavit, wherein the directors state that given time this company should be able to trade out of its current financial distress, are filed together with a form at CIPC, and the company is officially in business rescue.

One then needs to appoint a practitioner, who will help put together a business rescue plan, which is voted on by the creditors. “Once it is voted in, this plan becomes sacrosanct,” says Fleming.

Gordon goes on to confirm that the protection of business rescue is available to companies and close corporations. “Businesses operating outside of the company legislative regime such as sole traders, partnerships and trusts must rely on an informal turnaround. This is where Cobra can assist as it provides access to professional assistance at an affordable rate based on a means test.”

Turnaround rather than business rescue

Each distressed company represents a different set of possibilities, and it is essential they get this right from the beginning. “While business rescue is always an option, successful turnaround is the objective,” explains Gordon.

The process typically starts off as a meeting with the directors, in which the turnaround team sums up the problems and what the likelihood is of reviving the company.

Some of the possible options are:

- Business as usual with some minor interventions from the team.
- Informal turnaround, in other words, a turnaround project outside of business rescue.
- A section 155 compromise (legislated under chapter six of the Companies Act) where you negotiate a ‘haircut’ or compromise with each class of creditors and then have it made an order of court.
- A business rescue.
- A liquidation – which is normally the last resort or where the company is too far gone.

“Once we decide on a way forward we have to constantly assess whether the plan is working, being implemented correctly and whether it needs to be revised,” says Gordon. “If at any stage we believe that there is no reasonable prospect of saving the company, we are obliged by law to put that company into liquidation,” he says. “That is obviously a very heavy decision to make, and luckily we haven’t had to do it often.”

Post-commencement finance

Fleming explains that at the date of rescue, a line is drawn in the sand and that everybody who is in existence as a liability at that date is behind that line, and cannot be paid, other than through the plan. “Everyone that is supplying goods and services, including staff, are creditors in every rescue and they have a say in the rescue,” he says. “They have to be paid out of the rescue as a preferred creditor.”

As such, it is essential to raise post-commencement finance. “If you don’t have the money, you simply can’t do it,” says

Fleming. “If you are thinking of putting money into a company, whether to pay salaries or rentals and so on, please do not do so pre-rescue. If you do, your money drops into the concurrent creditor camp, whereas if you put it in post-rescue, you will become a preferred creditor.”

When is it too late?

The practitioners need to believe the company can be rescued. “This means we must hand back a solvent, sustainable business to the owners or do a controlled wind down to give creditors a better return than liquidation,” says Gordon. “If there is still a market for your product and you have the equipment and wherewithal to produce for that market, it is worth trying,” he adds.

He goes on to ask: “Who are you speaking to at the bank? If you are still negotiating with your bank relationship manager, you’re good. If you’re talking to the credit person a little more often, it’s getting a bit risky. If you’re talking to your bank’s business rescue unit, you’re probably in breach of your facilities, but it’s still not the end of the world, as business rescue practitioners are close with these units. The worst position is if you’ve already had a letter from the lawyers at the bank. Then it is almost too late,” he says.

Furthermore, if there’s an application for liquidation at the courts, a company cannot go into voluntary business rescue. “It may not be absolutely too late if we can negotiate with the applicant to withdraw their application, but it does complicate matters,” he explains. “But I hope from this, business owners will see that the bottom line is to rather seek help as early on as possible.”

For more information, visit Cobra.org.za or email peterg@crestcapital.co.za or ian@engagedbt.co.za

To help address the challenges faced by many, Saica hosted a complimentary virtual leadership series called Leadership in a time of crisis. This series focused on various elements affecting individuals, businesses and the profession as a whole during the Covid-19 pandemic. Sessions in this series have been recorded and can be viewed on Saica’s events page.

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The South African Institute of Chartered Accountants (Saica), South Africa’s pre-eminent accountancy body, is widely recognised as one of the world’s leading accounting institutes. The Institute provides a wide range of support services to more than 50, 000 members and associates who are chartered accountants [CAs(SA)], as well as associate general accountants (AGAs(SA)) and accounting technicians (ATs(SA)), who hold positions as CEOs, MDs, board directors, business owners, chief financial officers, auditors and leaders in every sphere of commerce and industry, and who play a significant role in the nation’s highly dynamic business sector and economic development.

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