
RESEARCH ON POST COMMENCEMENT FINANCE DATA FROM SOUTH AFRICAN COMPANIES IN BUSINESS RESCUE

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Dissertation submitted in partial fulfilment of the requirements for the degree of
MASTER OF COMMERCE specialising in FINANCE
in the field of FINANCIAL AND RISK MANAGEMENT

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July 2018

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List of Abbreviations

AUS	Australia
CAN	Canada
CIPC	Companies and Intellectual Property Commission
PIS	Public interest Score
SA	South Africa
SME	Small and Medium Enterprises
SI	Substantial implementation
USA	United States of America.
UK	United Kingdom

Plagiarism Declaration

Declaration:

I, Justin Gordon, hereby declare that the work on which this thesis is based is my original work (except where acknowledgements indicate otherwise) and that neither the whole work nor any part of it has been, is being, or is to be submitted for another degree in this or any other university. I authorise the University to reproduce for the purpose of research either the whole or any portion of the contents in any manner whatsoever.

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Acknowledgements

A special thank-you must go towards Prof. De Jager, Philip Adler-Murton and the practitioners who provided the information used in this paper. Without your assistance, this paper would not be possible.

However, nobody has been more important to me in the pursuit of this project than the members of my entire family but more specifically Sheryl, Douglas, Cassidy whose love and guidance are with me regardless of whatever I pursue. To my special Christine: I wish to thank you for your patience and unending encouragement.

Abstract

SA has one of the lowest survival rates of small and medium enterprises (hereafter referred to as “SMEs”), in the world (Edmore, 2011). Therefore, business rescue is critical in developing SA’s economy, as defined in Section 7(b)(i) of the Companies Act, No.71 of 2008 (“the Act”) which reads: “Promote the development of the South African Economy by encouraging entrepreneurship and enterprise efficiency”

The literature on business rescue concludes that post commencement finance is critical to the success of business rescue. However, to date, there has been no research performed on actual data collected from practitioners to answer the question of whether post commencement finance is a predictor of a successful business rescue

The findings of this study initially contradict the literature insofar as 56% of business rescues received post commencement finance: however, further investigation showed that only 7% of the total companies in this study received third party financial institutional post commencement finance, with the balance being introduced by shareholders.

The main finding of this study was that the introduction of post commencement finance is only a partial predictor of a successful business rescue. Thus, in the case of those companies which received finance, under business rescue, only 57% were successful.

Another finding of this study is that the combination that provides the best probability of successful business rescue is when equity, in the business rescue company, is made available after the successful adoption of the business rescue plan.

1. Introduction

This dissertation provides a descriptive analysis of the post commencement finance data retrieved from 109 business rescues and will attempt to provide more insight into the type and timing of post commencement finance whilst reviewing the success rates of business rescue companies that received post commencement finance. It is important to note that this is the first research performed using actual business rescue data received from practitioners specific to post commencement finance.

In order to provide context, 2867 companies have entered business rescue since 2011; of these, 1176 are still in business rescue as per the latest results published by the CIPC, as at 31 March 2018. In the case of those companies that exited business rescue, approximately 58% were successfully rescued. Furthermore, the CIPC statistics show that in the case of companies successfully rescued, only approximately 15% were liquidated after exiting business rescue. This indicates that business rescue has been very successful if one considers that the alternative, liquidation, results in an immediate loss of jobs.

There is very little literature on business rescue, mainly because Chapter 6 of the Act is relatively new. However, the available publications on post commencement finance identifies this as a critical success factor for rescuing a company. The literature further indicates that there is an inherent lack of post commencement finance in SA; the main reasons relate to the practitioner, the negative perception of business rescue and the conservative nature of the banks. There have been some developments within the business rescue industry that have addressed these main reasons for not introducing finance. Thus, case law has eliminated some of the misunderstandings concerning the ranking of post commencement claims in business rescue. Also, additional regulations have been imposed on practitioners by the CIPC. After reviewing the literature, it became evident that there is lack of data, outside of using business rescue plans, relating to post commencement finance. Any such data could be used to determine whether post commencement finance can be used as a predictor for the successful outcome of business rescue. This dissertation also provides insight into post commencement finance as applied by the USA, UK, Canada, Australia and compares the situation in those countries with SA. The dissertation makes the recommendation that the business rescue process should be amended to allow for an informal business rescue process to be attempted before a company can apply for business rescue.

The data used for this research was collected from six business rescue practitioners. After obtaining access to that information, a set of defined questions was applied to each business rescue and the answers were recorded and summarised accordingly.

In order to limit any practitioner's bias, referred to in the literature, only two sets of practitioner's data were selected to form the basis of the conclusion made in this paper. One of the contributing factors was that the practitioners must have been practicing since the inception of business rescue to ensure that the data was represented the entire period of business rescue which would eliminate variances in the data at one point in time effectively ensuring the information was through the cycle approach.

After the data was collected, using the defined questions, various descriptive analyses were performed; some of the findings contradicted the literature but other findings were in agreement. One interesting aspect of this research is that despite the perception created in literature, 47% of the six practitioners' business rescues had received post commencement finance. This percentage increases to 56% when reviewing the sample of the two practitioners from the data; one of these two practitioners achieved a noteworthy percentage of 71%.

The findings also suggested that the premise, in the literature, regarding a lack of post commencement finance is correct for third party financial institutions. Thus, more than 90% of the finance was shareholder related finance. This was raised either through the recapitalisation of the company by existing shareholders or through the sale of equity; in the latter scenario, no distinction was made between sale of a fresh issue of equity and the sale of existing equity. In some instances, there was a combination of both these scenarios. This highlights that a large amount of growth is needed in the industry before financiers begin placing funds into business rescue and stop adopting a "wait and see" approach.

Regarding the success of business rescue, the data obtained from the six practitioners indicated that 62% of business rescues that received post commencement finance had a successful outcome: the sampled two practitioners combined achieving 57% respectively. These results contradict some of the literature insofar as the introduction of post commencement finance is only a partial predictor of a successful outcome of business rescue.

In addition, data was also collected on the number of jobs saved by the two practitioners whenever a company was successfully rescued. Thus, according to the PIS submitted to the CIPC, approximately 893 jobs have been saved and this averages out at approximately 38 jobs per successful business rescue.

There were four major conclusions and contributions to theory that were developed in this dissertation. The first and primary one is that more post commencement finance is being placed into business rescue companies than the literature suggests; however only 7% of that finance was introduced by third party financial institutions with the balance of 90% being invested by shareholders. The second conclusion dealt with the question of what is the best combination of type and timing of post commencement finance that yields the highest probability of a successful rescue; it was shown that the best results are obtained when equity is transferred, in the business rescue company, after the adoption of the plan. The funds from the sale of shares are then utilised to settle creditors in accordance with the adopted plan. The third conclusion is that the number of jobs saved when a company is successfully rescued can be objectively identified using the PIS that is submitted to the CIPC upon filing the notice of substantial implementation. The fourth and final conclusion is that there are four basic reasons for the lack of post commencement finance in SA. These are: the negative perception surrounding the purpose and success of business rescue; the impact of the profile and actions of the business rescue practitioner; the conservative nature of traditional financiers, such as banks and finally, the business rescue is often entered into too late. It must be noted that various factors are impacting these four reasons such as further regulations by the CIPC, additional case law and education on business rescue. As a result, the four reasons should eventually reduce to just one: the risk appetite of financial institutions.

This dissertation proposes recommendations relating to amendments to the Act, the method of entering business rescue and the method of monitoring business rescue; all of these could have a significant impact on improving the business rescue industry.

Following this Introduction is a literature review which is performed within an initial context of business rescue and then specifically focussing on post commencement finance within a business rescue company. Subsequently, the data sources and method of collecting the information are disclosed, and the findings are discussed. This is followed by a summary of the limitations of the study, the recommendations and suggestions for possible further research. Finally, the conclusion is presented.

2. Literature review

This literature review will focus mainly on South African literature with a brief comparisons made to both international business rescue and post commencement finance structures. It must be noted that there is very little literature available on post commencement finance within business rescue. This lack of literature could be because business rescue was only promulgated seven years ago in South Africa and as such, is relatively new legislation. Since the provisions of Chapter 6 of the Act are not commonly practiced it is important to create context for this dissertation; therefore, context on business rescue will be provided in this literature review before turning to the issue of post commencement finance within business rescue.

Business Rescue

Business rescue is a mechanism in which a distressed company can be rescued within the ambit of the provisions of Chapter 6 of the Companies Act, No. 71 of 2008 (hereafter referred to as “the Act”). Chapter 6 states that a company’s debts may be compromised in order to ensure that it can continue to trade as a going concern.

Chapter 6 came into force on 1 May 2011 and it effectively replaced judicial management. The chapter was drafted after reviewing business rescue provisions in other countries; for example, “Chapter 11” in the United States of America, “Company Voluntary Arrangement” in the United Kingdom and “Deed of Company Arrangement” in Australia

Bradstreet (2010) has commented that Chapter 6 of the Act is better equipped to balance the rights of all affected parties, as defined in Section 7(k) of the Act, than judicial management or liquidation

The Act provides that a company may enter business rescue either voluntarily¹ or after being ordered to enter by a competent court.² The Act stipulates that a business rescue practitioner (hereafter referred to as “the practitioner”) is appointed³ to prepare a business rescue plan⁴ (hereafter referred to as “plan”) and must present that plan to affected parties for a vote. In terms of the Act, this must occur within 25 days from entering business rescue.

Before a company can enter business rescue it needs to meet two criteria:

1. **Financial distress:** not able to settle debts within the immediate ensuing six-month period, or, if the company is insolvent⁵
2. **Reasonable prospect:** There needs to be a reasonable prospect that the company is able to be rescued after a practitioner is appointed and the moratorium against legal action is provided.

¹ Section 129 of the Act

² Section 131 of the Act

³ After satisfying Section 138 of the Act

⁴ Section 150 of the Act

⁵ Section 129 of the Act.

There is no definition for financial distress in the Act. Cornelia (2016) evaluated *what is a reasonable prospect* and concluded that there is no single definition or model that can be used in isolation; identification of a reasonable prospect is reliant on the practitioner's experience and expertise.

After a company enters business rescue it gains the important advantage that, during the business rescue proceedings, there is a legal moratorium against legal action. This allows for some much-needed respite from existing debt holders so that the practitioner can prepare a plan to rescue the company successfully. The publication of a plan is a fundamental part of the practitioner's duties, as defined by Section 128(1)(b)(iii) of the Act and is the most critical of the five duties identified by Pretorius (2013). The respite from creditors afforded under business rescue ensures that the company can continue trading; this situation is in contrast to liquidation.

Once a plan is published, it may only be adopted if it is supported by 75% of all voting interests and 50% of independent voting interests. Shareholders, creditors and employees (referred to as Affected Parties) all have a voting ⁶ interest equal to the rand value of their claim submitted. Independent voting interests exclude related entities⁷.

It must be noted that even though the creditors vote on the plan, there is still the possibility that creditors may vote inappropriately and decide against it, even if it is in the interests of all affected parties to accept it, referring to the first principle of business rescue (Winer, Levenstein & Barnett, 2008).

If this happens, then there is a deadlock mechanism available whereby the court⁸ is able to deem the creditors' vote as being inappropriate and the "inappropriate" vote can be set aside; thereafter the plan can be adopted⁹ by the court as found in the judgement (Copper Sunset Trading 220 (Pty) Ltd v Spar Group Limited and Another (365/2014) [2014] ZAGPPHC 688; 2014 (6) SA 214 (LP) (9 May 2014), 2014).

Interestingly, the approval of business plans internationally does not rely solely on the creditors' vote, in contrast to the situation in SA. Thus, in both the UK and Canada the approval of the court is relied upon instead of creditors. Moreover, in the UK, approval of both the court and the creditors is required (Pretorius & Rosslyn-Smith, 2014).

Once a plan is adopted, the Act provides that the company's debts can be compromised in accordance with the contents of the adopted plan and the company can be signed out of business rescue as a going concern when the plan has been substantially implemented¹⁰.

In USA, Chapter 11 is used to implement a plan to restructure a company's affairs as a turnaround strategy is presented before the company is placed under management where as in SA a company can enter business rescue without a turnaround strategy and the business rescue practitioner is provided 25 days to develop the same. A recommendation is that the

⁶ Section 128 of the Act

⁷ Section 128 of the Act

⁸ As defined in Section 128(1)(e) of the Act

⁹ Should the remaining votes meet the requirements of Section 152(2) of the Act, and if necessary 152(3) of the Act.

¹⁰ As referred to in Section 132(2)(c)(ii) of the Act

current Act should be amended to allow for an informal process to be entered into, to develop a restructuring plan; business rescue is then used as tool to implement the plan.

As alluded to earlier, Chapter 6 is similar to other provisions internationally. The legislation in various other jurisdictions is summarised in the following table (based on du Preez, 2012).

	USA	UK	CAN	AUS	SA
Philosophy	Debtor friendly	Creditor friendly	Debtor friendly	Debtor friendly	Debtor friendly
Approach	<p>“Chapter 11”</p> <p>Prescribed process and predictable</p> <p>Upfront consultative process</p> <p>Mature investing market</p> <p>Strictly court driven with specialist’s solvency/rescue courts and specialised judges</p>	<p>“Company Voluntary Arrangement”</p> <p>High level of certainty</p> <p>Viability assessment performed before entering</p> <p>Mature Investing Market</p> <p>Strictly court driven with specialist’s solvency/rescue courts and specialised judges</p>	<p>Similar to USA and UK</p>	<p>“Deed of Company Arrangement”</p> <p>Consultative process with total consensus upfront</p> <p>Finance provided by administrator</p> <p>Strictly court driven with specialist’s solvency/rescue courts and specialised judges</p>	<p>Business rescue via Chapter 6 of the Act</p>
Official	<p>Turnaround CEO (Trustee)</p> <p>Not a practitioner but rather a part of management (Fiduciary obligation)</p>	<p>Administrator (Similar to liquidator)</p> <p>Does not take over running of the business.</p>	<p>Monitor (not a practitioner)</p>	<p>Administrator (Similar to liquidator)</p>	<p>Business rescue practitioner</p>

Table 1: Based on du Preez (2012), comparison of different “business rescue” legislation in the USA, UK, Canada, Australia and SA

Every company requires operational working capital and during a business rescue the provision of an immediate capital injection can make the difference between the business rescue succeeding or failing (Pretorius & Rosslyn-Smith, 2014). This is not only true in a South African context but is also applicable within international markets (Vriesendorp & Gramatikov, 2010).

After creating the context for business rescue and the importance of working capital, the literature suggests that post commencement finance is a critical element for the success of

business rescue. (See Bradstreet, 2010; Cornelia, 2016; du Preez, 2012; Freebody & Calitz, 2013; Lamprecht & Conradie, 2015; Lamprecht & Conradie, 2018; Maphiri, 2015; Naidoo, 2016; Pretorius & du Preez, 2013; Pretorius, 2013; Reineck, 2015). Therefore, the issue of post commencement finance within business rescue will be reviewed separately below.

Post Commencement Finance

The provision of post commencement finance is ultimately the introduction of funding into a company that has already entered business rescue. In terms of Section 135 of the Act, any funding which is approved by the practitioner is not constrained to one specific type; funding could be equity or debt finance and in some instances, a combination of these.

Post commencement finance is defined in Section 135 of the Act as the following:

135 (1) To the extent that any remuneration, reimbursement for expenses or any other amount of money relating to employment becomes due and payable by a company to an employee during the company's business rescue proceedings, but is not paid to the employee-

(a) the money is regarded to be post-commencement financing; and
(b) will be paid in the order of preference set out in 3(a).

(2) During its business rescue proceedings, the company may obtain financing other than as contemplated in subsection (1) and any such financing-

(a) may be secured to the lender by utilising any asset of the company to the extent that it is not otherwise encumbered; and
(b) will be paid in the order of preference set out in subsection (3)(b).

(3) After the repayment of the practitioner's remuneration and costs referred to in section 143, and other claims arising out of the costs of the business rescue proceedings, all claims contemplated-

(a) in subsection (1) will be treated equally, but will have preference over-

(i) all claims contemplated in subsection (2), irrespective whether or not they are secured; and
(ii) all unsecured claims against the company; or

(b) in subsection (2) will have preference in the order in which they were incurred over all unsecured claims against the company;

(4) If business rescue proceedings are superseded by the liquidation order, the preference conferred in terms of this section will remain in force, except to the extent of any claims arising out of the cost of liquidation."

Definition of post commencement finance per section 135 of the Act.

Within SA there is a noticeable lack of finance that is available to business rescue companies: Pretorius and du Preez (2013:170) view this as a significant reason why business rescue has not been as successful as it should have been, since 2011.

The definition of post commencement finance in Section 135 of the Act is specific to SA. Other countries address post commencement finance differently. The following table summarises the contrast between the various turn around provisions for the USA, UK, Canada, Australia and South Africa (du Preez, 2012)

	USA	UK	CAN	AUS	SA
Concept of post commencement finance	Yes, referred to as debtor in possession Financing (“DIP Financing”)	No special mention	Informally adopted DIP financing	No special mention	Yes, the concept is defined in the Act
Post commencement finance priority	Super-priority status after secured claims	No special mention	Super-priority status ahead of other creditors	No special mention	Yes, there is a priority as defined in the Act

Table 2: Based on du Preez,(2012), comparison of different treatment of “post commencement finance” internationally

Within the South African context there are no specialised institutions that focus solely on business rescue companies. However, Reineck (2015) developed a structure in which private equity firms could make use of certain income tax advantages when investing into business rescue companies. The provisions which allow the tax advantages are stipulated in Section 12J of the Income Tax Act, No. 58 of 1962. There is scope for this structure to be used more extensively in the local market.

Ms du Preez (2012) reviewed the status of post commencement finance within SA and outlined, in no order of importance, eleven main reasons for the reluctance of SA financiers to provide such funding:

1. The impact of the profile and actions of the business rescue practitioner.
2. Business rescue filing by distressed businesses for the wrong purpose and filing too late.
3. Negative business rescue culture and perceptions of business rescue in SA.
4. Banks are conservative and risk adverse due to regulations such as Basel 3 regulatory framework.
5. Concerns and uncertainty regarding the priority ranking of post commencement finance.
6. The financier risks losing money.
7. Lack of co-operation by banks during business rescue proceedings.
8. Distressed businesses do not readily involve and engage with financiers upfront prior to business rescue.
9. Financiers poor relationship of with management and business rescue practitioner.
10. The non-availability of security.
11. Financiers are not confident the business rescue is viable.

In addition to these eleven reasons, one should note some noteworthy contributions made by du Preez (2012) who was able to define both the different types and timing of post commencement finance. This issue will now be discussed.

Thus, the timing of the introduction of post commencement finance can be defined using the research performed by du Preez (2012)

Phase #	Phase Name	Timeframe and considerations
1	Critical and Emergency Funding	<p>New funding secured within the initial ten days of business rescue.</p> <p>This funding is required because whenever a company enters business rescue, its banking credit is immediately frozen. Creditors normally amend their trading terms to cash on delivery. This type of funding carries the highest risk and therefore the highest interest rate.</p>
2	Pre-Plan Funding	<p>New funding secured between Phase 1 funding and approval/adoption of the business rescue plan.</p> <p>The company is reasonably more stable, and the practitioner has had an opportunity to make a better assessment of the capital requirements of the company.</p>
3	Post-Plan Funding	<p>After the rescue plan has been adopted and until the business has completed the BR proceedings: the timing of publication of the BR plan is partly driven by the time required to stabilise the business, and to secure full refinancing package.</p> <p>This funding is only provided once the creditors have approved a plan which outlines how the company is to be restructured, both operationally and financially.</p>

Table 3: du Preez (2012), the three phases in which post commencement is introduced

The types of post commencement finance, according to du Preez (2012) are:

1. Asset Based Lending based on receivables and stock
2. Lending against any unsecured asset
3. Buy out the banks' debt at a discount
4. Buying equity in the business
5. Debt to equity swap, thereby effectively writing off the debt
6. Recapitalisation through a compromise with the creditors to inject additional funding
7. Buy up dissenting creditors' voting rights, thereby offering them what they would get in a liquidation and then pushing the plan through.
8. Shareholders put in additional money
9. A new entity buys out the existing debt and/or equity through acquisition
10. Sell some assets to raise capital
11. Additional overdraft funding

At this point it is worth referring back to the eleven reasons cited by du Preez (2012) concerning reluctance of financiers to provide funding. Freebody and Calitz (2013) (hereafter referred to as “Freebody”), followed on the work of du Preez (2012) and proposed that the six main reasons are as follows, summarised in order of importance:

1. The negative impact that entering business rescue proceedings has on the company profile.
2. The impact of the profile and actions of the business rescue practitioner.
3. Business rescue filing by distressed businesses for the wrong purpose and filing too late.
4. Business rescue culture and perceptions of business rescue in SA.
5. Uncertainty over the rankings of business rescue claims.
6. Banks are conservative and risk adverse due to regulations such as Basel.

Thus, Freebody’s (2013) contribution can be seen as being a reduction of du Preez’s (2012) initial list of eleven to six main reasons for a lack of post commencement finance in business rescue companies in SA.

In addition to Freebody’s reduction, Pretorius and du Preez (2013:181) surveyed business rescue stakeholders and provided data which seems to contrast reason 10 of the du Preez list insofar as the availability of security was not a major factor for practitioners or financiers.

Du Preez compiled the original list of eleven reasons by surveying various business rescue practitioners and her findings and conclusions were then used by Freebody (2013), as described above. This work took place more than five years ago and in view of this, there is scope to review current literature to see whether there have been any developments which could reduce, further, Freebody’s (2013) list of six reasons.

Each of the six reasons listed by Freebody (2013) will be reviewed to ascertain if there have been any further developments in the literature which could reduce the number of reasons for a lack of post commencement finance.

Freebody (2013): Reason number 1: The negative impact that entering business rescue proceedings has on the company profile

The negative impact of business rescue (Freebody reason 1) and the negative perception of business rescue (Freebody reason 4) are connected as the perception of business rescue has a negative impact on the company when it enters the proceedings.

It is difficult to suggest a specific reason for the negative perception of business rescue; the only possible reason is that there is a perception that the legislation is not effective. In particular, there appears to be a lack of knowledge of the provisions of Chapter 6 and furthermore, the published statistics also support this negative perception, according to Prior (2013:71); thus, many stakeholders will quote poor business rescue statistics which do not correspond with the business rescue statistics published by the regulator: the CIPC.

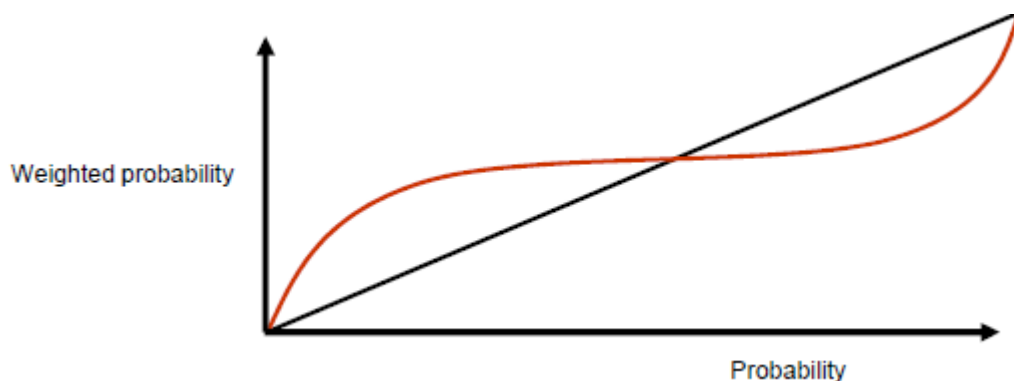
Mr Hobbs, Senior Business Rescue Practitioner, stated that this negative perception seems to have been created in the early stages of the implementation of Chapter 6 which gave poor levels of success. This negative perception not been adequately reversed, with stakeholders still quoting various poor statistics as a reason not to support business rescue.

This negative impact also impacts on business rescues filing for the wrong reason. In the early stages of business rescue the legislation was seen as a process to protect a company from entering liquidation rather than as a process to turn a company around successfully; not surprisingly, many of the companies followed through to liquidation. This finding is supported by CIPC statistics showing that as many as 29% of the business rescues filed in the first year of implementation were later set aside and declared a nullity.

One of the reasons why this perception prevailed beyond the years of early implementation is that during business rescue, creditors may be required to compromise debt and thus incur a loss. From a behavioural finance perspective, this can be seen in terms of the prospect theory whereby creditors have an loss aversion mentality insofar as how gains and losses are evaluated. In this instance, the loss is immediate and financial whereas the gain, which is often overlooked, is that a customer of the creditor continues to trade; this represents a future gain which could exceed the immediate loss.

Creditors will therefore overweight the extremely unlikely events and underweight average results; for example, a creditor will overweight a scenario in which the business rescue was just a manufactured liquidation and the rescue failed, resulting in the creditors writing off a substantial amount owed rather than average business rescues which a reasonable dividend greater than liquidation dividend is received.

The graph below depicts the cumulative weighted theory in so far as the actual probability is represented in black however the red curved line is the weighting applied to the outcome. This shows that where the probability at its extreme, ie wither very low or very high, these are “over weighted” compared with the actual proability being the black line. As mentioned earlier the business rescues that failed are often overwieghted thus the ongoing perception to business rescue is negative.



Source West. (2018). *cumulative prospect theory weighting*

Creditors may also associate business rescue with the loss incurred and so a negative perception is created; after all, creditors are ultimately asked to sacrifice debt in order to assist in ultimately growing the economy.

In order to combat the negative business rescue perception that business rescue does not work and only a small minority of companies are rehabilitated, the statistics provided by the CIPC, as at 31 March 2018, were analysed on a yearly basis to determine the effective success rate of business rescue since 2011. A table indicating the percentages of the companies that were successfully rescued after entering business rescue, is provided below.

Year	Success rate
2011-2012	54%
2012-2013	57%
2013-2014	58%
2014-2015	61%
2015-2016	60%
2016-2017	59%
2017-2018	53%
TOTAL Average	58%

Table 4: Source (CIPC, 2018) The calculated success of business rescue each year since 2011

The statistics indicated in the table show that the success rate in 2011 was not low enough to support this negative perception. As at 31 March 2018 there were 2,867 companies that have entered business rescue; of these, 1176 were still registered as ongoing active business rescues. One interesting fact to arise from the latest statistics is that 87 public companies have entered business rescue as at 31 March 2018. The corresponding figure for private companies was 1834, and this represents the largest category.

In reviewing the current business rescue statistics, there seems to be no reason to why this negative perception is still there, because almost 60% of the companies that entered business rescue proceedings were rescued. Taking into consideration the purpose of Chapter 6 and the fact that SA has one of the the lowest survival rates of SMEs (Edmore, December 2011) this is a significant success.

According to Mr Hobbs, Senior Business Rescue Practitioner, this negative perception will continue to persist and will only be eliminated by educating various stakeholders.

Beyond educating stakeholders, the literature states that only amendments to the Act (Reineck, 2015; Maphiri, 2015) will improve the perceptions of business rescue; this will allow a more regulated and transparent process which includes better regulations for practitioners (Bradstreet, 2010) and a better structure before entering business rescue (Maphiri, 2015). The better structure will mean that only true turnaround opportunities enter business rescue, and this would allow for a better introduction of post commencement finance, bearing in mind the reasons given by Freebody (2013) for a lack of post commencement finance.

On a positive note, it should be mentioned that the Act is in the process of being amended; however the draft legislation is not yet available for public comment.

A focussed public relations campaign could be used to inform stakeholders of business rescue successes; this, combined with these amendments to the Act, could be expected to limit the negative factors which could have resulted in the negative perceptions. Also, the findings of literature on behavioural finance may also assist in providing an understanding of the negative perceptions.

Freebody (2013): Reason number 2: The impact of the profile and actions of the business rescue practitioner

As stated above, in the section of this thesis dealing with business rescue, a practitioner must be appointed to oversee the business rescue proceedings of the company. Every company undergoing business rescue needs to have a practitioner and therefore management's

decision in selecting the correct practitioner is critical to a successful turnaround of the company (Midanek, 2012).

More specifically, the literature reveals that a practitioner is vital in determining whether post commencement finance is introduced into the company. For example, du Preez (2012) concludes that banks, as the most traditional source of funding, often base their decision to advance post commencement finance on who the appointed practitioner is; that practitioner's historic dealings with the bank are taken into account. An international survey (Vriesendorp & Gramatikov, 2010) showed that this "choice" made by banks was the leading reason for a practitioner not receiving the required funding.

Furthermore, the choice made by the bank also translates into a decision whether to support the plan; after all, the banks normally have a large vote and therefore can swing the acceptance or rejection of a plan. Therefore, a working relationship with the financial institutions is a factor which is critical not only for the introduction of post commencement finance but also for the success of the business rescue (Pretorius, 2014).

Baird and Lorence (2012) seemingly agreed with this view. They noted that there are no clear tools and systems which will predict, objectively, the success of turnaround practitioners; this led to a subjective viewpoint which focussed on the practitioner, before deciding on extending credit. It must be noted that although there are no tools or systems to predict the outcomes of business rescues, the Altman Z score can be used to gauge the level of distress experienced a company. Furthermore, Pretorius and Holtzhausen (2008) provided a model for practitioners to use in the turnaround of a company and suggested that if there were an 'issue' with several of the parameters then the turnaround would be more difficult.

After reviewing the importance of a practitioner, it is open to debate whether management should be responsible for the appointment of a practitioner (Pretorius & Holtzhausen, 2008). After all, it seems logical to assume that poor decision making by the management had a major role in the company becoming financially distressed in the first place. This view is supported by Edmore (2011:7). That writer's report, Global Entrepreneurship Monitor (GEM) 2001 – 2010, noted that "SA SME's suffer from poor management skills which is a result of lack of adequate training and education". Additional research (Pretorius & Holtzhausen, 2013:471) into reasons for, and early signs of, business failure found that poor management is a clear indicator of a decline in finance, operations, strategic decisions and banking.

Once a business rescue practitioner is appointed that person can only be removed through an application to court, which could be costly for the body of creditors; in the meantime the practitioner could utilise the company's resources to defend the litigation and remain appointed (Bradstreet, 2010).

The preceding discussion highlights the importance of appointing the correct practitioner because that person will play a critical role in engaging with various parties to receive post commencement finance.

Despite this critical role, there were few regulations concerning practitioners in the Act even though that Act provided practitioners with significant powers and authority. This disparity is one reason for the perception of business rescue as stakeholders judge the legislation by the actions of the business rescue practitioners rather than the benefit of the Act itself.

Bradstreet (2010) stated that if business rescue practitioners are not better regulated then this will damage the reputation of “business rescue;” this outcome would lead to a lack of trust in the process. This in turn would ultimately limit the amount of post commencement finance that is introduced.

Current literature suggests that the risk of appointing an unsuitable practitioner can be mitigated by ensuring shareholder approval of the practitioner before entering business rescue voluntarily; this can be done through restrictions in the memorandum of incorporation (Vanderstraeten, 2016: 6-7)

Furthermore, the CIPC has amended the process for recognising practitioners by stating that a practitioner must be affiliated to a recognised professional body which regulates its members in terms of minimum Continuous Professional Development hours while holding each practitioner accountable to its disciplinary code. This allows the affiliated body to determine what competencies are required. That body will only recognise those individuals who have met the key competencies and criteria.

However there are currently several different professional bodies and so there is no uniformity concerning the required competencies. This could lead a bank to prefer certain professional bodies on the basis of competencies and to have views on where the practitioner registered, before advancing post commencement finance.

In accordance with the CIPC notice to customers (Notice 05 of 2018) issued on 13 February, 2018, the professional bodies recognised by the CIPC are as follows:

- Institute of Accounting and Commerce (IAC)
- South African Institute of Professional Accountants (SAIPA)
- South African Institute of Business Accountants (SAIBA)
- South African Institute of Chartered Accountants (SAICA)
- The Association of Chartered Certified Accountants (South Africa) NPC (ACCCA)
- The Law Society of Northern Province (LSNP)
- The Law Society of KwaZulu-Natal (KZNLS)
- The Cape Law Society (CLS)
- The Law Society of the Free State (LSFS)
- The Institute of Business Advisors NPC (IBASA)
- The Chartered Institute of Management Accountants (CIMA)
- Turnaround Management Association (TMA)

The reputation and the role of a practitioner will always be important factors in attracting post commencement finance. However, recent amendments to the regulation of practitioners are intended to allow only suitable and qualified persons to be appointed as practitioners. Therefore, the appointment of unsuitable practitioners should, in due course, no longer be the sole reason to not invest post commencement finance.

Freebody (2013): Reason number 3: Business rescue filing by distressed businesses for the wrong purpose and filing to late

There is very little literature on this issue. However, business rescue has been seen as an alternative to liquidation proceedings rather than as a tool that can be applied to restructure the company's affairs and to save jobs and grow the economy. It should be noted that a

company can voluntarily enter business rescue within a relatively short period and once under business rescue a moratorium would exist; this situation can be used to protect the company from liquidation. The problem that often arises is that a company would be placed in business rescue against time pressure of the liquidation; therefore the viability of the turnaround of the business would not be assessed until it was in business rescue.

The premise that a company would file for business rescue too late can be expected to decrease as more stakeholders become aware of business rescue and that it is a viable option. The negative perception of business rescue also prevents companies from entering the process too early as the stigma attached to it could actually accelerate the financial decline of the company. If this negative perception can be reversed and if more education on the benefits of business rescue is regularly provided, then more companies will enter business rescue with sufficient time and resources to implement a plan accordingly.

Another issue that has emerged is that of the deadlines afforded to the practitioner within business rescue; often these are too tight to allow for a sufficient due diligence to be applied which in turn limits the type of funding that may be introduced to shareholder based funding, only.

Freebody (2013): Reason number 4: This was combined and discussed within reason 1 above.

Freebody (2013): Reason number 5: Uncertainty over the rankings of business rescue claims.

Chapter 6 of the Act attempts to mitigate the risk of introducing capital into a distressed entity by providing that introduced capital with a preferred ranking above other debt introduced into the company. The ranking determines the order in which debt is repaid from the sale of the company's assets. Importantly, this ranking still holds if the company is put into liquidation.

Most of Section 135 of the Act deals with the ranking of the claims. This matter was the subject of two relevant court rulings (Merchant West Capital Solutions (Pty) Ltd v Advance Technologies & Engineering Company (Pty) Ltd & Another, 2013) (Redpath Mining South Africa (Pty) Ltd v Marsden N.O. & Others, 2013). In both these cases, the courts addressed the ranking of claims under business rescue, which also holds under liquidation, in terms of Section 135(4) of the Act. The courts ruled as follows:

Rank	Description
1.	The business rescue practitioners remuneration and expenses: these include legal costs incurred by the practitioner.
2.	All remuneration, reimbursement for expenses and other amounts relating to employment payable in respect of employees for services rendered during business rescue proceedings are prioritised for payment next in terms of section 135(3)(a).

3.	Secured post commencement finance advanced after the commencement of business rescue is prioritised next in terms of section 135(3)(a)(i) and section 135(3)(b).
4.	Unsecured post commencement finance advanced after the commencement of business rescue is prioritised next in the chronological order in which it was incurred (section 135(3)(a)(ii)).
5.	Secured debts incurred prior to business rescue will be entitled to the next level of payment priority to the extent of the security implicit in the underlying security package.
6.	All remuneration, reimbursement for expenses and other amounts relating to employment payable in respect of employees for services rendered before the commencement of business rescue are granted preferred unsecured creditor status.
7.	All other unsecured claims arising prior to business rescue (other than specifically subordinated loans) are regarded as unsecured concurrent creditors
8.	Subordinated loans would receive priority only over equity funding.

Table 5: ranking of claims under business rescue

These two judgements have provided much-needed security for practitioners because, according to Pretorius and du Preez (2013:181) a lack of case law pertaining to the new legislation has been the key reason why there is a lack of post commencement finance in SA.

The rulings made in those judgements, summarised in the table above, show that despite misconceptions, a lender who provides funding into a business rescue is granted a ranking higher than a lender to a company not under business rescue. Furthermore, a company that provides post commencement finance is also afforded a voting interest and therefore an opportunity to vote on the future of the company under business rescue; this is in terms of Section 145 of the Act read with Section 151.

It follows, therefore, that creditors which have previously extended credit to a company should consider advancing further funding to both secure unencumbered assets, if the previous debt was not secured, as well as earn additional interest as the new debt would receive a preferred ranking thus reducing the risk, which will continue to apply even if the company is placed under liquidation, as defined in Section 135(4) of the Act. However, research has shown that this does not happen in practice as lenders would rather avoid extending additional credit (Pretorius & du Preez, 2013).

Section 135(2)(a) of the Act states that a practitioner may secure an asset to a lender provided that the asset is unencumbered.

It must be noted that there is a distinction made in the rankings between secured and unsecured post commencement finance. Interestingly, Pretorius and du Preez (2013:181) showed that a lack of available security was not a reason for a lack of post commencement finance in SA; this finding is positive because the financial institutions are often over-secured in accordance with their risk appetite, leaving few unencumbered assets.

With reference to the practitioner's powers to secure unencumbered assets Mindlin (2013) contrasted the SA situation with USA. That writer found that within the USA an administrator can offer security to a lender even if an asset is already secured; this is different to the provisions of the SA Act, which allows only the security of unencumbered assets.

After reviewing the literature, it seems that the concern over the ranking of the post commencement finance has been adequately addressed through case law and therefore can be removed as a reason for a lack of post commencement finance in SA.

Freebody (2013): Reason number 6: Banks are conservative and risk adverse due to regulations such as Basel 3 regulatory framework.

Banks are required to comply with to a banking standard known as the Basel Capital Accord which was established to ensure financial stability by ensuring that banks hold sufficient capital in order to meet the default risk on their respective loans. The Basel Accords have been revised over the years with the current one, known as Basel 3, being implemented across banks globally. The South African Reserve Bank currently requires banks to implement Basel 3. The link between the Basel Accords and business rescue arises because, once the company has been placed into business rescue, then any finance extended by the bank supposedly attracts a higher risk and therefore the bank is required to increase its capital held to compensate for the increased risk of default.

There is no literature suggesting any change to the risk appetite of banks towards companies that have entered business rescue. Further research is required to examine the banks' treatment of business rescue based on a Basel calculation scenario.

Conclusion on Freebody (2013) reasons.

The number of reasons for the lack of post commencement finance can be reduced to four with a possibility to reduce to three. In particular, and as discussed in Freebody Reason 5 above, the ranking of claims has been addressed in court: this has cleared up uncertainty over that particular issue. Reason 1 and reasons 4 can be grouped as they ultimately address the same topic therefore reducing the reasons to four. Even though there are still reasons relating to the business rescue practitioner, the CIPC has taken steps to regulate practitioners and it is reasonable to expect that, in time to come, these reasons will no longer be significant negative factors affecting the introduction of post commencement finance.

Du Preez (2012) reported that alternative financiers,¹¹ exist and these are separate from the normal channels such as banks, development finance institutions and shareholders. These alternative financiers hold the key to the future of the success of business rescue as they have a higher appetite for risk than banks, and therefore a higher propensity to invest the required funding.

Successful business rescue

After reviewing the reasons given for a lack of post commencement finance, the literature clearly supports the view that such finance is a critical component for a successful rescue of

¹¹ Which are a combination of distressed lenders and private equity firms

a company. However, there is no consensus on what a successful business rescue entails due to the broad nature of the definition as well as the context in which it is viewed.

“There is still a “lack of clarity” in the definition of a successful business rescue” (Naidoo, 2016).

Winer, Levenstein and Barnett (2008) viewed the success of a rescue by referring to the main purpose of Chapter 6 of the Act, which is primarily to restructure a company’s affairs (Objective one). If that was not successful then an attempt should be made to provide a better return that would result if the company were liquidated (Objective two). Lamprecht and Conradie (2015:22) suggested that there is an implied goal that the process should be beneficial to all affected parties, with the employees protected accordingly (Objective three).

Regarding “Objective two” Jacobs (2012) protested against the principle underlying it. Jacobs argued that this allows liquidators, effectively, to have a structured entrance into becoming a business rescue practitioner, adding that a liquidator may not always attempt to rescue the business as a going concern; instead the liquidator’s aim would be to wind down the company and provide the better return than under liquidation thus elevating the second principle.

Lamprecht and Conradie (2015:10) stated, based on international research, that the success of a rescue could be judged in terms of survival of the entity and survival of the business. Entity survival occurs when the company continues to trade within the same company registration number while business survival occurs when the core business is sold with the business continuing to operate under a completely different entity.

Lamprecht and Conradie’s later refined the meaning of success of a business rescue within a South African context (Lamprecht & Conradie, 2018:10) and provided a number of indicators which seem to support the definition given in Section 128(1)(h) of the Act. These are given below.

Thus, indicators relating to Objective one are:

- The business rescue plan was substantially implemented.
- The distressed company exited business rescue as a going concern.
- The rescue saved as many jobs as possible.
- The actual outcome of the business compares well to the one estimated in the plan, taking into consideration the time value of money.

Furthermore, the success of a business rescue also includes evaluating the performance of the company after Substantial Implementation (“SI”). The latest results published by the CIPC, for the period up to 31 March 2018, show that only 4.17% of the 480 companies that have exited business rescue, due to SI, have been placed in formal liquidation.

Lamprecht and Conradie (2018:11) also stated that if a business rescue is entered into purely with Objective two in mind, and afterwards deregistered, then this should not be a success factor in terms of business rescue but rather liquidation.

Lamprecht and Conradie’s current (2018) research gives indicators based on the objectives of the Act. However, in the Lamprecht and Conradie’s earlier research in 2015 they propose a undefined third objective: preserving jobs.

Interestingly, exiting business rescue as a going concern meets only the definition of “rescuing the company” if this is achieved through a plan. The definition is not consistent with other Sections of Chapter 6. A brief review of the sections of the Act, which contrast the definition of “rescuing the company,” is given below.

Section 128(1)(h) of the Act reads as follows:

*“(b) “**rescuing the company**” means achieving the goals as set out in the definition of “**business rescue**” in paragraph (b);*

Section 128(1)(b) of the Act reads as follows:

*“(b) “**business rescue**” means proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for –*

(i) the temporary supervision of the company, and of the management of its affairs business and property;

(ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and

(iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company’s creditors or shareholders than would result from the immediate liquidation of the company.”

However, Section 141(2)(b) of the Act, reads as follows:

“(b) If there no longer are reasonable grounds to believe that the company is financially distressed, the practitioner must so inform the court, the company, and all affected persons in the prescribed manner, and –

(i) If the business rescue process was confirmed by a court order in terms of section 130, or initiated by an application to court in terms of section 131, apply to court for an order terminating business rescue proceedings; or

(ii) otherwise, file a notice of termination of business rescue proceedings”

The above notice, if filed, then ends the business rescue proceedings in terms of Section 132(2)(b) of the Act which reads as follows:

(2) The business rescue proceedings end when -

(b) the Practitioner has filed a notice of termination of business rescue proceedings

On the subject of financial stress, which is a pre-requisite for entering business rescue, Section 141(2)(b) read with Section 132(2)(b) of the Act demonstrates that a company can be removed from business rescue and may continue to trade as a going concern, therefore surviving as

an entity (See discussion in Lamprecht & Conradie, 2015). Furthermore, Lamprecht and Conradie (2018:10) added that a company exiting business rescue as a going concern meets the definition of the principal objective of business rescue. The latest CIPC results as at 31 March 2018, show that 11.15% of the 602 companies that have exited business rescue, due to termination of business rescue proceedings referred to in 141(2)(b) of the Act, have been placed into formal liquidation. This indicates that SI has the best survivorship percentage and is the preferred “successful rescue indicator”.

It must be noted that the notice of termination of business rescue proceedings is not enough to indicate a successful rescue: in practice that notice has also been incorrectly filed when the company is being liquidated, in terms of Section 141(2)(a) of the Act.

Summarising the success of a business rescue has been the subject of recent literature; that literature includes four indicators for a successful rescue. However, the Act provides only two ways in which a company can meet the definition of a successful rescue. There is evidence that suggests that a company exiting business rescue and trading as a going concern, in terms of Section 141(2)(b) of the Act, should also be included in the definition of a successful rescue. If this suggestion is adopted it would increase the number of success indicators, in terms of the Act, from two to three.

CONCLUSION

The literature on business rescue was reviewed with specific emphasis on post commencement finance. This involved either interviews, theoretical research or the review of business rescue plans. None of the authors had direct access to data which could be used to determine whether, in reality, post commencement finance plays a role in predicting the success of the business rescue.

One of the reasons for the lack of such data, as stated by Pretorius and Rosslyn-Smith (2014), is that there is no section of the Act which demands that the practitioner must disclose, in a plan, what post commencement finance has been introduced into the distressed company and the resulting financial ramifications. This situation limits any research to practitioners who are willing to provide more in-depth insight into concluded business rescues. Reliance solely on practitioners can be a problem as turnaround specialists often do not wish to disclose their intellectual property and trade secrets; this obviously limits the available information for further research.

3. Data and Method

Data and method will be discussed separately. Method will be divided into two sections, namely the gathering of information and the descriptive analysis of the gathered information.

Data

Fortunately, six practitioners volunteered access to their records and they were also available to answer questions and to provide clarity, if required. The six practitioners, between them, have been appointed to 109 business rescues.

It was important to apply a further filter for the six practitioners. This was because, according to the literature, the selection of the practitioners will be crucial as there is a “practitioner bias” when financiers decide whether to introduce post commencement finance.

Therefore, in order to reduce the impact of this practitioner bias, the number of practitioners was filtered to those who meet the parameters, stated below. Another limitation is that sampling was limited to those who have gained in-depth information concerning more than 50 business rescues.

The practitioner filter parameters were as follows:

- i. The practitioner needs to be in good standing with a professional body recognised by the CIPC.
- ii. The practitioner needs to be recognised by the CIPC as a senior business rescue practitioner.
- iii. The practitioner’s first appointment must have been before 2012. This requirement is intended to cover the entire cycle of business rescue since it came into implementation.
- iv. The practitioners are still operating and have accepted an appointment within the previous six months.

Based on the above parameters, only **two practitioners** were selected for this research. The profiles of the practitioners are as follows

	Practitioner 1	Practitioner 2
Good standing	X	X
Senior Practitioner	X	X
>20 appointments	X	X
First appointment	2011	2011
Still operating	X	X
Number of appointments	36	22

Table 6: Information on the two sampled business rescue practitioners

These two practitioners operate in Cape Town and Johannesburg respectively. They have more than 60 years of business experience and have been appointed to oversee a combined total of 58 business rescues. Because these practitioners have been operating since inception of business rescue proceedings the data is perceived to be through the cycle.

For confidentiality reasons the business rescue companies and the two practitioners’ details will remain anonymous: each business is allocated a number ranging from 1 – 58 at random. The research is not specific to one industry and therefore none of the two practitioners’ business rescues will be excluded from this research.

Following the selection of the practitioners, certain questions will be applied to each business rescue; these are indicated in the following discussion of the research method. The results are summarised and recorded in table format.

Method – Gathering of Information

After receiving access to the data, a series of further questions was applied to each business rescue and the results were summarised. The questions are:

Question 1: **Was the business rescue successful?**

Question 2: **Was post commencement finance introduced?**

Question 3: **(If applicable): what type of post commencement finance?**

Question 4: **When was the post commencement finance introduced?**

The rationale for each question will be explored further, below. At this stage, note that there is a specific sequence for the four questions, as some include the collection of further data. It is important to note that the purpose of using standard questions was to provide objectivity and eliminate bias, however, this is difficult to maintain the possibility of bias should be taken into consideration when reviewing the analysis.

The first question is: "Was the business rescue successful?". If the answer was **YES**, then the methodology of the successful rescue will be questioned. In the event that the business rescue was achieved through SI, then the public interest score (PIS), submitted when the company exited business rescue, would be reviewed to determine the number of jobs saved.

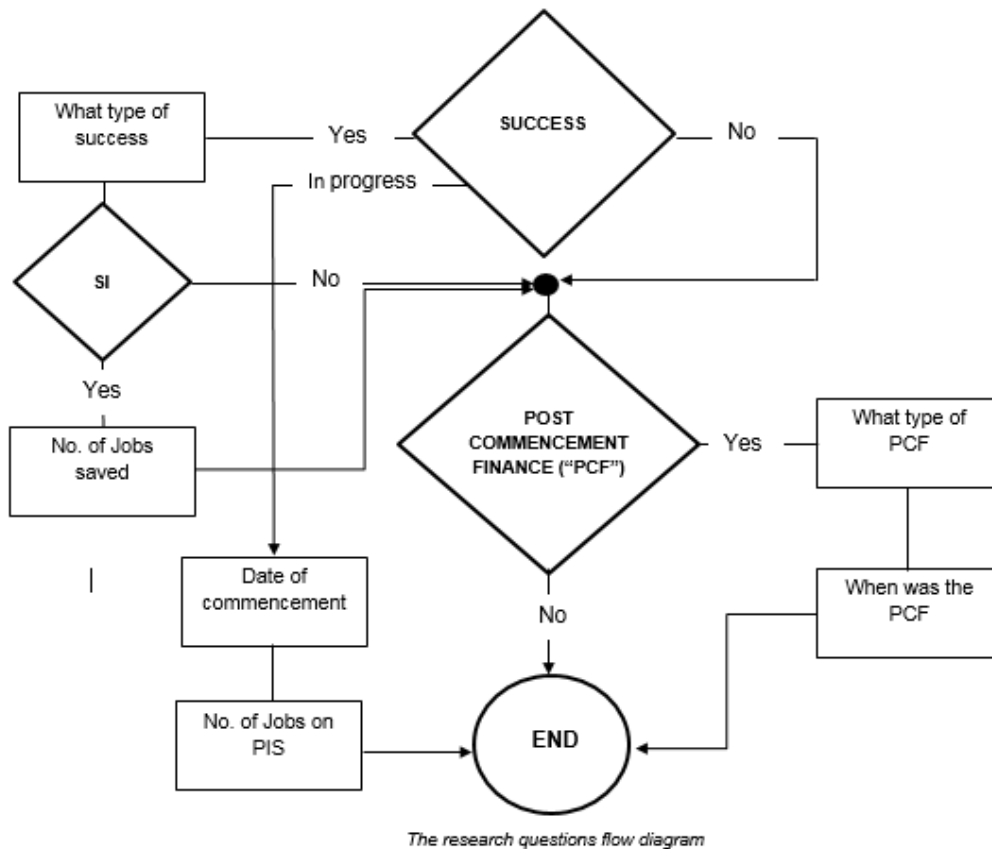
If the answer to the question "Was the business rescue successful?" was **NO**, then the second question "Was post commencement finance introduced" would be asked and reviewed.

If the answer to the second question was **NO**, then that would conclude the question sequence for that specific business rescue company and the process would begin with a new business rescue company.

However, if the answer to the second question was **YES**, then the third question concerning the type and timing of the post commencement finance would be asked, and the question sequence would end.

In the event that the company was still in the progress of business rescue then the date of commencement of business rescue would be recorded as well as the number of jobs listed on the PIS when the company entered business rescue.

The sequence can be summarised into a flow diagram as shown below:



The data collected for each of the four questions is discussed below, together with a summary of the rationale for each question.

Question 1: **Was the business rescue successful?**

The answer to this question can only be yes, if the business rescue meets the following criteria, which are based both on the findings of this dissertation and those of Lamprecht and Conradie (2018):

1. (Goal 1) Adoption and the subsequent implementation of a plan, with the company being removed from business rescue, as defined in Section 132(c)(ii) of the Act.
2. (Goal 1) The company is no longer financially distressed and is removed from business rescue proceedings in terms of Section 141(2)(b) of the Act.
3. (Goal 2) Providing a greater dividend than under liquidation, in accordance with Section 128(1)(b)(iii), and the company is removed from business rescue as defined by Section 132(c)(ii) of the Act.

A further indicator for the success of the rescue was identified by Maphiri (2015) and Lamprecht and Conradie (2018): this was the number of jobs saved during business rescue. Therefore, data on this subject was collected to provide further information and insight.

The specific method of collecting the information was based a review of the PIS of a company entering and exiting business rescue. The PIS requires the company to disclose the number

of employees; moreover, when SI has been achieved, the CIPC requires submission of a PIS at the time of exiting business rescue. Therefore, the number of jobs can be recorded objectively based on the submitted PIS. Unfortunately, this only applies to companies that were successful due to SI. In other instances the practitioner's records are used to determine the number of jobs saved.

The number of jobs saved is a second focal point in line with the findings of Lamprecht and Conradie (2015:22). However, this will not be the primary definition of the success of a business rescue although it will provide information on companies that have successfully been rescued. This information can be used to combat the negative perceptions of business rescue, which, as stated previously, form a major reason for the lack of post commencement finance in SA.

Question 2: Was post commencement finance introduced?

The term 'post commencement finance' refers to the introduction of funding into a company that has already entered business rescue. Post commencement finance will be defined as funding introduced into the company after business rescue commenced, in terms of Section 135 of the Act; such funding would have been subject to approval by the practitioner.

Post commencement finance is not constrained to one specific type of funding: it could refer to equity or debt finance and in some instances a combination of the two.

Question 3: What type of post commencement finance?

The different types of post commencement finance will be defined and restricted to those identified by du Preez (2012). Each of the types will attract a number from 1 – 11.

It must be noted that for the purposes of this research the writer has exercised some discretion regarding the "sale of assets" as a type of post commencement finance; here, the intention is not skew the results because the businesses could sell inventory which is classified as an asset, therefore meeting the definition for this research. In those instances where the sale of assets is considered to be post commencement finance, reasons are provided.

Question 4: When was the post commencement finance introduced?

In accordance with du Preez (2012), post commencement finance is categorised into three phases. The reader may recall that these three phases are described in Table 3 On page 14 of this report. These phases will be used as a basis to identify whether the timing of the post commencement finance has any influence on the success of a business rescue.

Below is the second section within the method section.

Method – Descriptive analysis of information

Following the answers to the above questions the data will be summarised and further analysed with a view to providing answers to the research questions as well as with the aim of providing additional insight into post commencement finance.

Success rate of the business rescue practitioners

The number of successful rescues will be analysed as a percentage of the total number of the practitioner's business rescues that have exited business rescue. The formula applied will be:

Equation: $(X1 + X2 + X3) / (Z - P)$

Z	=	number of business rescues that have exited.
X1	=	number of SI.
X2	=	number of winding up
X3	=	number of "no longer financially distressed
P	=	number of business rescues that are ongoing.

This data will provide an indication of the success rate of the practitioners compared with the current industry average, as reported by the CIPC. This information will be used to examine the perception of business rescue.

One reason for using the parameter "number of jobs saved" is because this can be quantified precisely. It is given in the submissions to the CIPC and it is linked (Lamprecht & Conradie, 2015:22) with research which states that the number of jobs that have been saved during business rescue is a determinant of success. Therefore, data analysis is performed as follows:

The number of jobs saved (based on PIS)

A record has been kept of the number of jobs that were saved upon exit from business rescue, based on the public interest score submitted to CIPC. This information accompanies the statistics on successful business rescue and it can be used to improve the perceptions regarding the success of business rescue. The average number of jobs saved per business rescue is calculated using the following formula:

Equation: $J / (Z - P)$

J	=	number of jobs saved.
Z	=	number of business rescues that have exited.
P	=	number of business rescues that are ongoing

It must be noted that only in cases where the business rescue company exited through substantial implementation could a reliable number of jobs saved figure could be recorded by reviewing the Public Interest Score.

Post commencement finance vs no post commencement finance

The premise of the literature is that there a lack of post commencement finance in SA and one reason for this is a negative perception of business rescue. Therefore, in order to review the negative perception data is required on the number of companies that received post commencement finance. This can be compared with the total number of business rescue companies in the data sample. The following calculation provides this information:

Equation: $Y / (Z - P)$

Z	=	number of business rescues that have exited.
P	=	number of business rescues that are ongoing.
Y	=	introduction of post commencement finance

This analysis will be compared to the findings quoted in the literature.

Post commencement finance and successful rescues

Data will be analysed to answer the question of whether post commencement finance is a predictor of the success of a rescue. The following formula will be applied:

Equation: $Y / X1$ or $Y / X2$ or $Y / X3$

X1	=	number of SI
X2	=	number of winding up
X3	=	number of "no longer financially distressed"
P	=	number of business rescues that are ongoing.
Z	=	number of business rescues that have exited
Y	=	introduction of post commencement finance

Post commencement finance and unsuccessful rescues

The number of unsuccessful rescues which made use of post commencement finance will provide a contrast to this figure and possibly provide data which supports the proposition that post commencement finance is not a sole indicator for the success of a rescue.

Equation: $(C \& Y) / (Z-P)$

C	=	number of unsuccessful business rescues
Y	=	introduction of post commencement finance
Z	=	number of business rescues that have exited
P	=	number of business rescues that are ongoing.

Type of post commencement finance and successful rescues

Since there is a lack of research performed on actual business rescue data, further analysis was performed on both the type and timing of the post commencement finance. The following formula was applied:

Equation: $(D1/X1,2,3)$

D1	=	the type of post commencement finance, as defined
X1	=	number of SI.
X2	=	number of winding up
X3	=	number of "no longer financially distressed"

Type of post commencement finance irrespective of outcome of the business rescue proceedings

The preceding data analyses only take into consideration the type of post commencement finance for successful and unsuccessful business rescues in isolation. However, this analysis provides insight into the predominant type of post commencement finance. The calculation is:

Equation: $D1,2, 3... / (Z-P)$

D1	=	the type of post commencement finance, as defined
X1	=	number of SI.
Z	=	number of business rescues that have exited
P	=	number of business rescues that are ongoing.

Timing of post commencement finance and successful rescues

The data will be analysed to provide insight into whether timing of post commencement finance can be attributed to a higher probability of success.

$$F = (T1/X1,2,3)$$

T1 = timing of post commencement finance, as defined

X1 = number of SI.

X2 = number of winding up

X3 = number of "no longer financially distressed"

This will be contrasted against unsuccessful rescues, whereby X is replaced by C (being number of unsuccessful business rescues)

The combination which leads to the most successful predictor of success

This analysis will combine the above analyses both in terms of type and timing of post commencement finance to answer the third research question. The formula is:

$$F = (D1+T1)/ (Z-P)$$

D1 = the type of post commencement finance, as defined

T1 = timing of post commencement finance, as defined

Z = number of business rescues that have exited

P = number of business rescues that are ongoing.

4. Findings

The findings relating to the success rates of the two business rescue practitioners sampled in this research provide context on the overall research. The findings provide possible insight into possibly-omitted variables. These findings can be directly linked to the negative perception of business rescue which the literature indicates is the main stumbling block for the introduction of post commencement finance into business rescue companies.

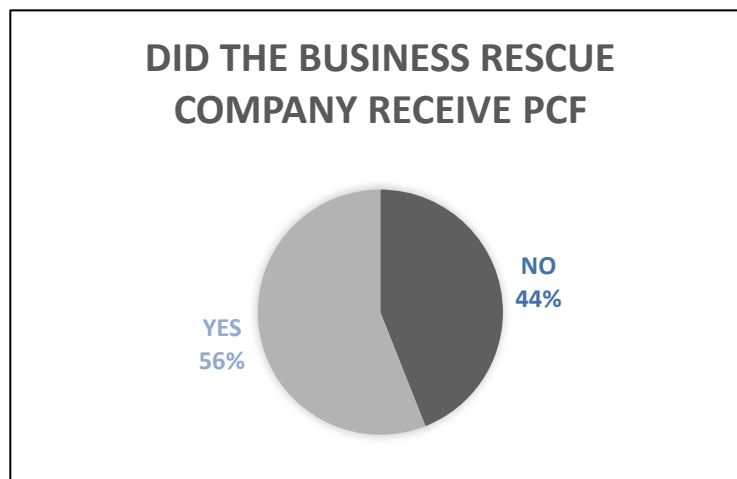
Total business rescues	58
Less: business rescues still trading	8
Total number of business rescues (for this research)	50
Successful business rescues	23
Success rate of the two practitioners	46%
Business rescue success rate - CIPC	58%

Table 7: Calculation of the two practitioner's success rates

As indicated in the Table above, the success rate of the two practitioners chosen for the research is below that of the industry average as calculated in the literature review. This factor is kept in mind in the following review of the other data. It must be noted that the success rate of all six of the practitioners originally approached was 42%

According to the literature, the two practitioners' relatively limited success rate compared to the industry average, in isolation, should mean that they have been less successful in raising sufficient post commencement finance in order to rescue the companies.

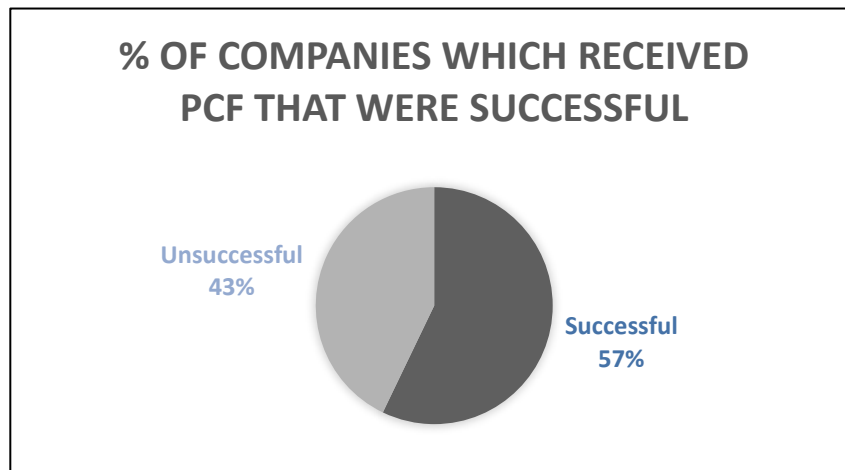
However, in contrast to this assumption the results show that more than half of the two practitioner's business rescue companies, excluding those that are still on going, received post commencement finance. Below is a graphical representation of the result:



Against the background of literature claiming a "lack of post commencement finance" the percentage was expected to be lower than 56%. This unexpected result may be because of financiers "practitioner bias" toward the two practitioners; this was confirmed when reviewed against all the data in which only 47% of the business rescues received post commencement finance.

The literature refers to an accepted relationship between the success of a business rescue and the provision of post commencement finance. Therefore an assumption is made that 82% of the business rescue companies that received post commencement finance were ultimately deemed to be successful. This percentage is derived by dividing the earlier success rate of the practitioners by the total number of companies that received post commencement finance. (46% / 56% = 82%)

However, the actual findings indicate that only 57% of those companies that received post commencement finance were successful, as defined in this research.



These results indicate that there is not a strong relationship between post commencement finance and the successful rescue of companies in business rescue. The relationship could be described as partial with only a margin of 14% separating a success or a failure. The findings of the literature review suggested that the difference would be far greater.

The need duly arose to acquire a better understanding of why there was a rather large difference between the earlier assumed statistic of an 82% success rate for companies entering business rescue, and the actual figure of only 57%. Therefore, the two statistics were combined to arrive at an exploratory assumption that 70% of the companies that were successfully rescued received post commencement finance (57% / 82% = 70%).

This assumed relationship only focusses on the companies that were successfully rescued. It must be noted that the data supported this exploratory assumption in that 70% of successful business rescues received post commencement finance.

Number of successful business rescues + post commencement finance	16
Total number of successful business rescues	23
Percentage of successful rescues which received post commencement finance	70%

Table 8: Calculation of the two practitioners successful business rescues which received post commencement finance

As stated previously, this figure of 70% pertains only to the successful business rescues; therefore, it cannot be used as a “predictor” at the beginning of business rescue.

One worrying statistic is that 43% of the business rescues that received funding did not succeed. This immediately raises questions surrounding the perception, held by some, that reliance on post commencement finance is the sole success factor.

As stated earlier, assumptions were made using the two practitioners' information and it was found that the number of jobs saved in the fifty business rescues was 783. Therefore, an average number of 34 jobs per successful business rescue were saved. Using the total number of business rescues the data reflects that on average, 15 jobs were saved in each attempt at business rescue.

The research excluded the business rescues that were still in progress. One could argue, therefore, that those jobs would also effectively have been saved if the company continues to trade for a minimum of six months, which is the period required for financial distress. The data reflected that of the 58 business rescues conducted by the two practitioners, eight were still in progress. Of those, one had been trading for 74 months and another for 13; it would seem therefore that the jobs still remaining in those two instances have been saved. In view of this, the total figure for the number of jobs saved includes these two instances.

After this inclusion, the total figure for the number of jobs saved increased to 891, giving an average of 38 jobs saved either by trading for longer than six months or through the company successfully exiting business rescue.

In summary, a review of the data showed that a surprisingly high 56% of business rescue companies selected for this research received post commencement finance. This contradicts the literature which almost unanimously refers to a shortage of such finance. Of those companies which received post commencement finance, only 57% were successful. This finding indicates that post commencement finance is only a partial predictor of a successful business rescue. Additionally, those successful business rescues resulted approximately 891 jobs being saved at an average of 38 jobs per company that has either by traded for longer than six months, under business rescue, or through the company successfully exiting business rescue.

It is at this point that the type of post commencement finance becomes a critical issue, bearing in mind that the findings of this research indicate that post commencement finance is more common in practice than the literature suggests.

Initially the type of post commencement finance was examined only in the case of successful business rescues, based on the formula in the research design. The data was collected and is summarised in the table below:

	Quantity	% of total
Asset Based Lending based on receivables and stock	1	6%
Buying equity in the business	7	44%
Shareholders inject additional money into the business	8	50%
Total post commencement finance for successful rescues	16	100%
No post commencement finance	7	
Total successful business rescues	23	

Table 8: Percentages of different types of post commencement finance that **successful** business rescues received

These findings agree with the findings of the literature: thus, there is a lack of a post commencement finance market and this is evident because in most instances, commencement finance was introduced via shareholders.

“Buying equity in the business” makes reference specifically to an external party acquiring equity in the business rescue company, thus an automatic change in shareholding. Where as

the “shareholders injecting additional money” does not necessarily result in a change in shareholding as the additional funds can be introduced via debt.

Further analysis was performed on the type of funding irrespective of if the company was successful or not, and below are the findings accordingly:

	Quantity	% of total
Asset Based Lending based on receivables and stock	2	7%
Buying equity in the business	8	38%
Shareholders inject additional money into the business	18	86%
Total companies that received post commencement finance	28	100%

Table 9: Percentages of different types of post commencement finance that business rescues received

In the two cases of asset-based lending, that lending was performed by financial institutions. As indicated in the table, above, shareholder recapitalisation is the most common type of post commencement finance within the sample of business rescue companies studied. It is interesting to note that of the eight companies that received equity as post commencement finance, all were successful.

The data shows that there is not a lack of general post commencement finance but rather a lack of financial institutions introducing post commencement finance into business rescue companies.

The only outstanding findings are specific to the timing of post commencement finance which will be detailed below and then combined with all the other relevant formulas to provide the combination of post commencement factors that will lead to the high probability of success.

On the subject of the timing of post commencement finance, two noteworthy findings arose from the research. One finding was that post commencement finance can be introduced in more than one phase during the business rescue; indeed, in some instances a company received post commencement finance in three phases. Therefore, and in order to obtain a more reliable result, the total number of times such finance was introduced was considered rather than the total number of companies receiving it.

The second finding was that in some instances there was a time delay between phase one and phase three which exceeded the prescribed deadline of 25 days to prepare a plan. In these instances, there was an extension to the plan which the creditors approved.

	Quantity	% of total
Phase 1: within 10 days	4	19%
Phase 2: after 10 days before the plan	9	43%
Phase 3: after the plan	8	38%
Total	21	100%

Table 10: Percentages of the different phases in which post commencement finance was introduced

The findings relating to the timing show that post commencement finance is rarely introduced within the “critical phase of a business rescue” and is only introduced once the practitioner has more time to analyse the company and approach financial institutions. This could also show that there is a due diligence delay relating to the amount of time a practitioner has to gather correct information and quantify the post commencement finance required.

The results of this research found that the combination of both timing and type of post commencement finance that provide the best probability for successful rescue is when equity is sold after the adoption of a plan. This finding represents a useful addition to the existing literature.

It was shown that the sale of equity is the best option for post commencement finance, being better than “shareholder injected money into the business.” The reason for this is even though the shareholder injecting further money only has a 44 % success rate (8 successful rescues / 18 total companies that received this type of post commencement funding) were as the “buying equity” type has a 87.5% success rate.

5. Limitations to this study

The data used in this study was limited to the evidence collected from six practitioners that were willing to provide the same therefore the sample was non-representative and It is not possible to generalise using this limited amount of information obtained from the sources.

Furthermore, this research omits reference to additional variables in each business rescue that could have had a role to play in the company being successful or unsuccessful, in the absence of post commencement finance. The reliance solely on post commencement finance does provide a certain amount of insight but does not show the whole picture. The results need to be taken within this context.

There are limitations in the data gathered because questions could only be answered with a yes or no. In view of this, certain scenarios would not have been reported on. For example, there could have been some post commencement finance introduced, with the amount being insufficient for the company to trade successfully. Further research could examine this issue.

6. Suggestions for further research:

The literature review has shown that no research has been performed on post commencement finance, using data from business rescue practitioners. In view of this finding, there is much scope for further research:

- **The failure rate of business rescues which had post commencement finance secured before entering business rescue proceedings.** The outcome of such research will provide support for the view that business rescue could possibly follow the Chapter 11 in the USA approach. Here, PCF is secured before a company enters business rescue. Comparable legislation in other jurisdictions utilises the compromise of debt as a tool to implement a plan rather than allowing a company to enter business rescue hastily, after which a business plan is developed.
- **The amount of post commencement finance that has been invested.** This will also assist in determining if the post commencement was sufficient to successfully rescue the company.
- **Total number of jobs saved during business rescue.** The CIPC does not publish these results and the number of jobs is a positive aspect of business rescue that can be used to combat the negative perception of business rescue.

- **The percentage of jobs that were lost during business rescue.** The difference between the PIS data upon entering business rescue and the PIS data when exiting business rescue can indicate the number of jobs “lost” during business rescue.
- **The reasons for the business rescue not being successful.** Research on this subject can be performed by reviewing each business rescue from the perspective of business rescue practitioners who are willing to divulge the information. This information will enable the researcher to present a list of reasons why business rescues were not successful; this, in turn, could guide amendments to legislation. The reliance solely on practitioners for this information could be a problem as turnaround specialists often do not wish to disclose their intellectual property or trade secrets. This attitude would limit the availability of information for further research.
- **Return on post commencement finance.** Research on this topic should enable practitioners to present reliable information to financial institutions when requesting post commencement finance. It could, perhaps, address the conservative nature of certain finance houses.
- **Post commencement finance per industry.** There may be different results for different industries; if so, this finding could provide data allowing the ranking of those industries that receive the most post commencement finance. This in turn could reveal any correlations with the levels of success in each industry, as published by CIPC.
- **Are the timeframes within Chapter 6 of the Act sufficient time to raise capital?** The amount of time required to raise different types of finance should be determined and measured against the time frames allowed; these findings could provide data to support proposed amendments to the Act.

7. Recommendations

The following recommendations are separated into three headings: amendments to the Act; amendments to the financing of business rescue; and; amendments to the monitoring process of business rescue.

Amendments to the Act:

- **The Act should include post commencement finance as a prescribed requirement of a plan.** Currently Section 150 does not require the practitioner to disclose any information on post commencement finance. Should this change then it will allow for further research and also will assist in educating stakeholders on post commencement finance under business rescue.

Amendments to the financing of business rescue:

- **Include business rescue funding for practitioners and rescue plans by government departments with the sole aim of saving jobs.** A practitioner is afforded an opportunity to investigate a company and present a pre-packaged business rescue plan to government organisations like Industrial development corporation (“IDC”) . If the plan is approved then business rescue is entered into with

the sole purpose of implementing the plan. The fees for the practitioner are settled by the government.

Amendments to the monitoring process of business rescue:

- **Amend the process of entering business rescue to include answering if post commencement finance has been secured before approving the business rescue.** This recommendation is put forward in the light of the USA approach, in terms of which post commencement finance is secured before a company enters Chapter 11 and will allow for more data to be collected by the CIPC for further research.
- **The Public Interest Score must also be completed when a company exits business rescue after filing a notice of termination of business rescue.** This will allow for better research into the number of jobs saved; at present, the SI is the only method which records jobs saved.
- **Include the amount of post commencement finance received into the public interest score submitted to CIPC when filing the notice substantial implementation.** This will allow for further research into the post commencement finance market within SA,
- **CIPC must publish the number of jobs saved by business rescue:** The CIPC does not publish the number of jobs that have been saved by a business rescue. Thus, a critical aspect of business rescue is not being published. Indeed, information on the number of jobs saved could hold the key for changing the negative perception that business rescue doesn't work, and is merely buying time before a liquidation.
- **CIPC must calculate and publish the success rates of business rescue practitioners.** This will allow for more informed and better decisions to be made when appointing a practitioner.

8. Conclusion

Business rescue and post commencement finance remain contentious topics. This contention will only be addressed and possibly resolved through further research and education. In the literature review six reasons were initially put forward for a lack of post commencement finance in SA. It was shown that these six could be reduced to four reasons in due course. Moreover, given the assistance of the CIPC and the development of case law, these could be reduced even further to one reason: the risk appetite of financiers.

The research data reveals that 56% of the fifty eight sampled business rescue companies received post commencement finance: this finding seems to contradict the literature that states, uniformly, that there is a lack of post commencement finance in SA.

However, further analysis indicated that even though there seems to be significant amounts of post commencement finance, only 7% of that was advanced by third party financial institutions. This indicates that a lack of non-shareholder related post commencement finance in SA.

The data showed a partial relationship between the introduction of post commencement finance and the ultimate success of the business rescue: thus, only 57% of the companies that received post commencement finance were successful. Therefore, the introduction of post commencement finance can only be used as a partial predictor of the outcome of the business rescue. This partial relationship seems to contrast the perception that one main reason for the failure of a business was a lack of post commencement finance: the data suggests that there are other seemingly more important or specific reasons than post commencement finance.

Regarding the most efficient type and timing of post commencement finance, the data reveals that the sale of equity through a plan provides the highest probability of a successful business rescue.

Analysis of the business rescues studied in this research showed that 783 jobs were saved in twelve of the successful business rescues. However, this increases to 891 jobs after including two companies which have been in business rescue for more than a year. This presents a positive key performance indicator rather than relying solely the two sampled practitioners success rate of 46% and the recommendation is that these statistics of the number of jobs is regularly published, by CIPC, and reported on by news agencies.

In summary, this research refined the premise of post commencement finance within SA by reviewing the data from fifty business rescues. Based on the outcome of the research it is proposed that there is a specific lack of non-shareholder related post commencement finance being introduced into business rescue companies. Furthermore, the introduction of post commencement finance is only a partial predictor of success insofar as only 57% of companies that received such finance were eventually successful.

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