

# Business rescue: How can its success be evaluated at company level?

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## ABSTRACT

The question of what constitutes a successful business rescue is a very topical and unanswered one. Reports on success are contradictory and seem to lack a set of standardised evaluation criteria. The purpose of this article is to investigate how business rescue success is evaluated internationally in order to develop a set of criteria that can be used to evaluate business rescue success at company level in South Africa. A comparative review approach was used to investigate data from four leading international countries with similar business rescue regimes. A number of evaluation criteria were identified and aligned with the business rescue legislation as set out in Chapter 6 of the South African Companies Act. The findings indicated that the international business rescue regimes and Chapter 6 share similar goals. Several criteria for evaluating success were identified, the key indicators being the going concern status on exiting business rescue, and whether the return to creditors was maximised as opposed to liquidation. It was further found that an initial exit as a going concern may be a short-term success indicator. Success can ultimately only be established if further investigation after some time period indicates no re-filing for business rescue.

**Key words:** business rescue, South African Companies Act, success, evaluation, going concern, liquidation, stakeholders, restructuring

## Introduction

“Measurement is the first step that leads to control and eventually to improvement. If you can’t measure something, you can’t understand it. If you can’t understand it, you can’t control it. If you can’t control it, you can’t improve it.”

H. James Harrington

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The South African Companies Act (No. 71 of 2008) introduced a business rescue regime for financially distressed companies. The Chapter 6 business rescue provision has been available to financially distressed companies since 1 May 2011. A successful business rescue regime is likely to have an impact in the South African business world in general, and a direct impact on various stakeholders such as creditors, employees and customers. The quality of corporate rescue legislation will depend mainly upon the principles by which it is measured (Hunt & Handa 2005). According to the Companies and Intellectual Property Commission (CIPC), the success of business rescue legislation in South Africa must be monitored closely to ensure that South Africa sets an example not only nationally, but also internationally (CIPC 2014).

The question of what constitutes a successful rescue is very topical among academics and practitioners, with no answers to date (Pretorius 2013). Some initial statistics that have been published paint different pictures: in March 2013, Webber Wentzel reported a success rate of 55% out of a sample of 117 companies in the period May 2011 to March 2012 (Webber Wentzel 2013). Terblanche, a director with professional services firm Mazars who is responsible for its business rescue services division, reported an 8% success rate for 2012, while mentioning that statistics circulated by the CIPC during 2013 reveal a real rate of success of between 12% and 15% of all businesses that have concluded their rescue operations (Terblanche 2014). Using the CIPC's figures for terminations indicated in the 'Notice of substantial implementation' filings, Pretorius (2014: 28) calculates the success rate as 9.4%.

Apart from Pretorius's calculation, none of the other reported statistics disclosed the criteria used for the evaluation of success. It seems that no formal set of evaluation criteria or guidelines is available. Van Schalkwyk, a team manager of the CIPC's business rescue division, confirmed the notion and indicated that research into such a set of evaluation criteria would be valuable to the CIPC (D. van Schalkwyk [Team leader], pers. comm., 29 February 2014).

Research in the corporate recovery sphere has focused mainly on two aspects. Firstly, a vast body of literature exists for predicting financial distress and developing models to assist stakeholders with these predictions, most notably Altman's Z-Score and ZETA™ models (Altman 1968: 589; Altman, Haldeman & Narayanan 1977: 29). Secondly, researchers focused on what constitutes a good rescue regime and analysed individual rescue regimes to identify strengths and weaknesses, or compared and contrasted different rescue regimes to each other in order to identify principles that, if applied or removed, would lead to the success of the particular regime. Factors such as the manner of entering the proceedings, the extent of court involvement, how voting is conducted, the various costs for the affected parties, how speedy the regime

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is, whether or not an external administrator is preferable, and the information that a creditor would need to take a decision on the company's future, were often debated (Routledge & Gadenne 2000; Denis & Rodgers 2007; Anderson 2008; Krüger 2010; Yang & Li 2012). However, limited research has been undertaken to evaluate the success in terms of the goals of the particular regime. The low incidence of research in this area is also surprising, given the importance of determining how well any changes to a regime, such as those aspects highlighted above, contributed to the saving of financially distressed business, and the related benefits to society and the economy as a whole.

### Aim of the study

The CIPC, which acts as the regulator of business rescues in South Africa, needs to report on the success of business rescue legislation for its own performance evaluation purposes, and also for transparency to the general public and government. The drafting, implementation, monitoring, improvement and reporting of any piece of legislation is expensive. At the moment, reporting to the public on business rescue is limited to the recording of basic statistics such as the number of companies entering business rescue, the number of notices to end proceedings, and the number of appointed and licensed business rescue practitioners (CIPC 2013: 21).

In order to evaluate the success of the current South African business rescue regime, one needs to evaluate the outcome of individual companies that went through the business rescue process. Therefore, the aim of this paper was to develop a set of success indicators at company level that are fit for the South African business environment and supportive of the purpose of the South African business rescue legislation, and not to elaborate on the legislation itself.

Using the indicators to evaluate success will aid the Department of Trade and Industry as legislator and the CIPC as regulator to better understand the effect of the current legislation and to improve the overall success of the business rescue legislation in the long term.

In order to achieve the research aim, the study attempts to answer the following research questions:

- What are the goals of the legislation?
- Based on international legislation, are there criteria, supported by indicators, that can be used to evaluate the success of the regime at company level?
- Based on international legislation, if criteria and supporting indicators are available, can they be used or adapted for use in the evaluation of success in a South African business rescue context?

## Research design

The study was guided by the research questions indicated above, and designed in the manner set out in Table 1 to achieve the research objective.

**Table 1:** Research design components

<b>Component</b>	<b>Description</b>
Research question or problem	Are there criteria, based on international legislation, that can be used to evaluate business rescue success in South Africa at company level?
Context	Business rescue
Propositions	The goals of the rescue legislation are clear; There are criteria, supported by indicators, that can be used to evaluate the success of the business rescue regime at company level; and These criteria and indicators can be adapted and applied to evaluate the success of Chapter 6 business rescue in South Africa at company level.
Phenomena investigated	The goals of business rescue legislation; and The evaluation criteria and indicators involved.
Units of observation	Literature; International rescue regimes; and South African Companies Act (No. 71 of 2008), with specific reference to Chapter 6.
Logic linking the data to the propositions	The goals, success evaluation criteria and indicators should be available in the international literature to judge a rescue regime at company level.
Criteria for interpreting the findings	Similar goals to South African business rescue legislation; Success evaluation criteria and indicators used in international business rescue regimes; and Applicability of the criteria to Chapter 6 business rescue in South Africa.

Source: Adapted from Yin (2009: 27); Pretorius & Holtzhausen (2013: 473); Pretorius & Rosslyn-Smith (2014: 125).

The paper draws data from current legislation, as well as from empirical and non-empirical research, to understand how the success of a chosen regime is evaluated at company level in countries other than South Africa, particularly those countries that have used similar corporate rescue regimes for some time. To this extent, legislation, research and other relevant information pertaining to the corporate rescue regimes in Australia, Canada, the United States of America and the United Kingdom were studied in order to note how the success of the chosen regime was determined in terms of its stated goals.

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The nature of the research was descriptive, of a qualitative form and relied on textual data. The focus was on theory construction/discovery (Olalere 2011: 22). The researchers therefore applied grounded theory principles to the comparative review of data from within the business rescue context and were theoretically sensitive to recognise any themes and patterns emerging from the data (Olalere 2011: 24). The data were accordingly systematically and simultaneously collected and analysed for themes on and patterns in the evaluation of the success of a business rescue regime at company level (Goulding 2002: 170). A recent study by one of the leading South African researchers in business rescue has successfully implemented the grounded theory approach to gain international directives on the expectations of the business rescue plan (Pretorius & Rosslyn-Smith 2014).

The next section briefly describes the goals of the South African business rescue legislation, followed by the investigation and analysis of the data (legislation, empirical and non-empirical research and other relevant information) on the international rescue regimes. The literature review is followed by the section describing the findings and linking the findings to the different research propositions in order to arrive at a set of criteria to evaluate the success of business rescue in South Africa.

### Literature review

In order to investigate how international rescue regimes are being evaluated, the sections below are set up as follows: for each country investigated a brief introduction is given into the available legislation, with special emphasis on the goals of the legislation, before investigating how the success of the particular regime is evaluated.

### South Africa

The Companies Act of 2008 defines “business rescue” as proceedings to facilitate the rehabilitation of a financially distressed company through the temporary supervision of the affairs, business and property of the company. The temporary supervision is allowed under a temporary moratorium on the rights of claimants against the company or in respect of property in its possession, while a plan to rescue the company by restructuring its affairs, business, property, debt, other liabilities and equity is developed and implemented 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 (RSA: s. 128(1)(b)).

The goal of the legislation, and what can be considered a successful rescue in terms of the legislation, can be seen from the above, namely that a rescue will be considered successful if the company will return to continue in existence (i.e. a going concern), or if the realisation of assets under business rescue will result in a better return for the company's creditors and shareholders than under immediate liquidation.

Business rescue proceedings may be initiated voluntarily by the company through a board resolution, or may be initiated by an affected person by application to the court. A business rescue practitioner is appointed with specific powers and duties (see Companies Act Chapter 6, Part B) and takes full management control of the company in place of its board and management. The practitioner is responsible for the development of a business rescue plan to be considered by affected persons at the second creditors' meeting, and the implementation thereof once it has been adopted (RSA: s. 129, 131, 151 & 152).

The Act states that business rescue proceedings end when (a) the court sets aside the resolution or order that began the proceedings or has converted those proceedings into liquidation proceedings; or (b) the practitioner has filed with the CIPC a notice of the termination of business rescue proceedings; or (c) a business rescue plan has been (i) proposed and rejected in terms of Part D of this Chapter, and no affected person has acted to extend the proceedings in any manner contemplated in section 153; or (ii) adopted in terms of Part D of this Chapter, and the practitioner has subsequently filed a notice of substantial implementation of that plan (RSA: s. 132).

Although the saving of jobs is not a specific goal as set out in section 128(b), the rights of employees are protected during business rescue proceedings. Their rights are protected due to the fact that immediately before the beginning of the proceedings, employees of the company continue to be employed on the same terms and conditions, except to the extent that changes occur in the ordinary course of attrition, or the employees and the company agree different terms and conditions in accordance with applicable labour laws. Any retrenchment of an employee contemplated in the business rescue plan is subject to the applicable sections of employment-related legislation (RSA: s. 136).

According to Bradstreet (2011: 371), the South African Companies Act is now also in line with developments in international insolvency law by providing for informal "work-outs" or "pre-packaged" administrations. To this extent, Part E of Chapter 6 deals with a compromise with creditors and applies to a company, irrespective of whether or not it is financially distressed (S 155 (1)). Bradstreet (2011: 371) describes the compromise with creditors as an informal alternative to the business rescue

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proceedings. It should be noted that this study focuses only on the formal business rescue proceedings as described in parts A to D.

If we want to evaluate the success of South African business rescue legislation, are there any international criteria or guidance with indicators of success that we can study and adapt to serve as criteria and indicators for business rescue success evaluation in South Africa? The next section investigates how success is evaluated in the United States of America, Canada, Australia and the United Kingdom at company level.

### United States of America

Reorganisation in the United States is governed by Chapter 11 of the Bankruptcy Code of 1978. Chapter 11 reorganisation has been put in place as an alternative to immediate liquidation of a business, which is dealt with under Chapter 7. Debtors sometimes file for liquidation under Chapter 11, rather than Chapter 7, because it is economically more advantageous than liquidation under Chapter 7. It also permits the creditors to take a more active role in the liquidation process (United States Courts 2014). The focus of this study is on an evaluation of the outcome of the Chapter 11 reorganisation plan, rather than the liquidation plan.

Once a debtor files for a Chapter 11 reorganisation, there will be a 120-day moratorium on the rights of creditors. During this period, the debtor (current management) remains in control of the company, also known as the debtor-in-possession principle. The debtor is responsible for fulfilling all duties with regard to the Chapter 11 filing. One of the responsibilities of the debtor will be to file a plan of reorganisation, which is similar to the business rescue plan under the South African business rescue proceedings. The US trustees mainly monitor the progress of a Chapter 11 case (United States Courts 2014).

Reorganisation plans need to be approved by the majority of creditors, and ultimately by the court (Dal Pont & Griggs 1996: 48). The court must be satisfied that all requirements of the legislation are met. Among other things, section 1129 requires the plan to be feasible (Dal Pont & Griggs 1996: 49). In order to satisfy the feasibility requirement, the court must find that confirmation of the plan is not likely to be followed by a liquidation (unless the plan is a liquidation plan) or further financial reorganisation (United States Courts 2014). According to the drafters of Chapter 11, the purpose of reorganisation is to restructure a business so that it may continue to operate, provide its employees with jobs, pay its creditors and produce a return to its shareholders. The Supreme Court of the United States said that the

main purpose of Chapter 11 was to prevent a company from going into liquidation (Jensen-Conklin 1992: 301).

From the above, it is clear that a company is expected to continue as a going concern post-Chapter 11 reorganisation. One criterion of “success” is emergence from Chapter 11 as a going concern, and another is that the company does not re-file for Chapter 11. The following paragraphs investigate which indicators were used by different researchers in order to evaluate the success of reorganisation cases.

The Administrative Office of the United States Courts did a study on Chapter 11 cases filed after 1987. Of the cases studied, 30% resulted in confirmed plans for reorganisation (some of which would experience financial stress again in the future), and about 30% included plans for the piecemeal liquidation of assets (Rasmussen 1991: 322).

It is relatively easy to distinguish between the number of going concern entities and liquidated entities exiting Chapter 11, but is this distinction enough to determine success? According to Hotchkiss, John, Thorburn & Mooradian (2008: 31), researchers need to evaluate the performance of a going concern company for some time post-Chapter 11. If a company performs poorly post-Chapter 11, then Chapter 11 only prolonged the liquidation process of an unprofitable company. Continued poor operating performance or further restructuring following Chapter 11 reorganisation implies that the reorganisation failed, as the company is not economically viable in the long run.

If reorganisation success depends on the subsequent performance of a company, this brings us to another question: How do we evaluate subsequent performance of going concern entities? Hotchkiss et al. (2008: 33) found that 40% of the companies they examined experienced operating losses in the first three years after Chapter 11 reorganisation. Ratio analysis such as return on assets and profit margins were used as indicators of a successful reorganisation. Aivazian and Zhou (2012: 235) used either the operating income over total assets or cash flow over total asset ratios as performance indicators. Based on operating income, the performance of Chapter 11 cases was on par with their matched peer companies (companies that did not file for Chapter 11). Changes in cash flows for Chapter 11 cases, from the pre-filing year to the first post-filing year, were found to have improved dramatically. Aivazian and Zhou (2012: 230) were able to evaluate some of the companies in their original investigation for another three years, and found that improvement in operating cash flows was more pronounced in the long run.

According to LoPucki and Whitford (1992: 600), a reorganisation would be considered a success if the company emerged from bankruptcy with less debt or improved profitability, or both. This indicates that debt ratios and, once again,



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profitability ratios are important. Aivazian and Zhou (2012: 247) found that reorganised firms significantly reduce liabilities to help boost their net operating cash flows after emerging from bankruptcy. Debt ratios used in their investigation include the quick ratio (to measure liquidity), interest cover ratio, market value of equity over total liabilities, secured debt over total liabilities and trade credits over total assets.

Alderson and Betker (1999) evaluated post-Chapter 11 performances by calculating an estimated return that could have been earned if the company's assets were liquidated and the proceeds invested in a portfolio of shares. They took the market value of 89 companies five years after emerging from bankruptcy, added all cash distributions that were made to claimholders, and compared this amount to an estimated value if the assets would have been liquidated at emergence. This annualised return was compared to the return of the S&P index over the same time period. Based on cash flow returns, the Chapter 11 companies performed on par with the market as a whole (Alderson & Betker 1999: 68). Although the annualised return success indicator seems to be an evaluation of company performance rather than an evaluation of a Chapter 11 success, the indicator is indeed important as it shows that Chapter 11 reorganised companies can be economically viable and perform on par with other companies in the long run.

In the evaluation of post-Chapter 11 performance of a company, one should keep in mind that operating profitability after emergence will probably be strongly related to the share performance of the overall market, and not all companies emerging from Chapter 11 will relist their shares. Hotchkiss et al. (2008: 34) found that only 60% of the companies they studied relisted on a stock exchange. Therefore, studies of post-bankruptcy share performance may be biased to reflect only the best-performing companies (Hotchkiss et al. 2008: 34).

It is unclear how long a company should stay under the magnifying glass, as no definite time period for "post-restructuring assessment" was found. Aivazian and Zhou (2012) studied the operating performance of public companies that filed for reorganisation from 1987 to 2008. Their investigation extended from the pre-filing year to the end of the first post-filing year. According to Kahl (2002: 136), it takes time to understand whether a company is economically viable or not. Various subsequent restructurings do not necessarily mean that reorganisation was a bad idea (Kahl 2002: 136).

Firms usually downsize their assets significantly during reorganisation attempts (LoPucki & Whitford 1992: 604; Aivazian & Zhou 2012: 247). This makes one wonder whether the evaluation of success might be influenced by a dramatic decrease in company size or by acquisition by another company (Warren & Westbrook 2009:

610). LoPucki and Whitford (1992: 602) use the term “shattering” when evaluating post-reorganisation performance. Shattering occurs when a significant part of a company is sold off in small parts to different buyers, or shut down because of lack of interest. If, without the sale of the key business, a company’s assets fall by more than 50% during the period of reorganisation, the company is considered to have shattered (LoPucki & Whitford 1992: 602). Liquidation plans often will mean that equity holders will lose their stake, but the business and its employees may continue under new ownership following a going concern sale. However, a liquidation plan may also mean the individual sale of a company’s assets, which is not very different from a typical Chapter 7 proceeding (Warren & Westbrook 2009: 611).

LoPucki and Whitford (1992: 603) further distinguish between “entity survival” and “business survival” when evaluating reorganisation success. From a corporate law point of view, survival means that a company emerges from reorganisation as the same legal entity, even though the assets it owns have changed radically. This is known as “entity survival”. It may, however, be more important for suppliers and customers that the key operations of the business survive, rather than the legal entity. This is called “business survival” (LoPucki & Whitford 1992: 602). For LoPucki and Whitford (1992: 602), the core business at filing must remain intact in a single company in order for the filing to be successful. This will be the case if a major portion of the assets remain under common ownership and fundamentally are committed to the same business purpose, whether that ownership is maintained by the same entity or in a new one. In a number of the Chapter 11 cases investigated, only a shell of the original company emerged from Chapter 11 for the principal purpose of preserving and using accumulated net operating losses (LoPucki & Whitford 1992: 612).

A reorganisation plan can be converted to a Chapter 7 liquidation plan if any party in interest files a motion to dismiss or convert the Chapter 11 case to a Chapter 7 case. The court will ultimately decide if this is in the best interest of the creditors and the estate (United States Courts 2014). Research has, however, shown that liquidating a company after an unsuccessful attempt at reorganising is expensive. Creditors would receive more if the company had originally filed for liquidation in terms of Chapter 7 (Rasmussen 1991: 322).

It could be argued that Chapter 11 is a success if a company is liquidated, as long as this is in line with the agreement that is in place with the stakeholders. Sprayregen, Kieselstein and Seligman (2006: 25) believe that the most important thing in a reorganisation is how the company pictures its future post-reorganisation. In other words, how does the company define success for itself (Sprayregen et al. 2006: 25)? Chapter 11 reorganisation cases are considered successful by bankruptcy lawyers if reorganisation plans are confirmed (LoPucki & Whitford 1992: 599). However, this

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indicator is not in line with the ultimate goal of Chapter 11 reorganisation, which is that the company must emerge as a going concern.

The previous paragraphs discussed the evaluation of Chapter 11 cases, mostly from a legal and financial point of view. It can be argued that bankruptcy legislation should also consider those who do not have a legal claim against the company, but are nevertheless affected by the continued operation of the company (Rasmussen 1991: 324). A business may provide its employees, suppliers and customers with a sense of belonging that makes them feel secure and enriches their enjoyment of life. When a business shatters, this intangible benefit may be lost. This loss does not mean that shattering is an inappropriate outcome for Chapter 11 reorganisation, but it should be weighed against the gains that result from the redeployment of assets when a company shatters (LoPucki & Whitford 1992: 604).

Although the social impact mentioned above is a valid consideration, it could also be argued that bankruptcy law is not the place to address such a social concern (Rasmussen 1991: 324). One can have compassion for employees that are dismissed, but it may be unreasonable to expect business reorganisation to address these problems. From a straightforward business perspective, business reorganisation could be seen as successful if it provides the best return to the company's creditors (Rasmussen 1991: 324).

To conclude this section, a summary of the evaluation criteria used by researchers is given. Research performed on Chapter 11 showed that reorganisation success can be evaluated by the following criteria and supporting indicators:

- Distinguishing between reorganisations, a shattering outcome (better return to creditors) and going concern asset sales;
- Determining if the outcome was in line with the accepted plan;
- Measuring the subsequent performance of an entity that has exited as a going concern through the use of ratios such as return on assets, profit margins, debt ratios as well as annualised returns in comparison to matched peer companies;
- Determining the number of times the entity subsequently re-filed for Chapter 11;
- Determining the return the creditors received under reorganisation compared to what would have been received from immediate liquidation; and
- Considering the impact on other stakeholders by measuring the change in asset size, and determining whether the core business was kept.

## Canada

Canada distinguishes between big companies and smaller companies when it comes to restructuring legislation. Companies with debt of over CAN\$5 million

can apply for restructuring under the Companies' Creditors Arrangement Act (CCAA). Smaller companies can apply for restructuring under the Bankruptcy and Insolvency Act (BIA). These two acts are the same in spirit, with small technical differences (Hunt & Handa 2005: 2). The purpose of the CCAA is to allow for the restructuring of bigger companies in order for the company to continue operations as a going concern (Rotem 2008: 16). In terms of the CCAA, liquidation is not part of the plan and must occur separately from and after the CCAA procedures have been followed (Sarra 2003; Hunt & Handa 2005; Rotem 2008). A restructuring plan (plan of arrangement) must be accepted by the majority of creditors of each class, and also by the Canadian court (Pretorius & Rosslyn-Smith 2014: 122).

It might be relatively easy to see how many companies emerged from these restructuring procedures solvent and as going concerns. Once again, the difficult aspect is to evaluate how well these rescued companies perform in the long run, unless one believes that any restructuring is inherently better than liquidation (Kent, Rostom, Maerov & Weerasooriya 2008: 1). One will need to quantify the ability of the company to remain solvent and be a vibrant member of the economy.

According to Hunt and Handa (2005: 27), one also needs to determine if the overall return to creditors is in line with their expectations. Consideration must be given to the improvement in operations, and the benefit of returning a business that might potentially become insolvent again in future to the business world (Hunt & Handa 2005: 27).

Research done in Canada indicates that the effectiveness of their restructuring legislation can be evaluated by asking the same questions as in the United States. As a starting point, the following questions would be relevant: How many companies return to solvency once they enter creditor protection? How many companies liquidate once they enter creditor protection? Of the companies that liquidate, what is the average return to creditors? (Hunt & Handa 2005: 27).

Oliver Hart argues that an optimal reorganisation procedure must maximise the proceeds received by the existing claimants (Fisher & Martel 1999: 235). Again, it should be borne in mind that economists may evaluate success differently from socialists. The Canadian government expressly states that the goal is to protect all stakeholders, thus including clients and employees (Sarra 2003: 85). The general consent is that an otherwise viable company that requires temporary protection from creditors to return to solvency should be allowed this chance for survival (Hunt & Handa 2005; Rotem 2008: 125). This will ensure future employment and give better protection to suppliers (Sarra 2003: 92).

Pritchard (2004: 118) noted that it is difficult to determine the success of CCAA proceedings in terms of asset value and recovered value. Pritchard (2004: 118)

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eventually decided that respondents would be questioned about how far the case had proceeded. The ultimate criterion of success was whether the plan had been carried out successfully. The Superintendent of Bankruptcy in Canada uses the same standard in assessing the success of proposals under the BIA. As no standard was seen as perfect, the investigators concluded that the study should focus on those cases where the company had proposed a plan of arrangement that had been accepted by its creditors, approved by the court and carried out (Pritchard 2004: 116).

A study was done in Canada on all CCAA cases that commenced between 1997 and 2002. It was decided that a case would be seen as successful if the court-approved plan was implemented. Of the 79 cases examined, 37% were successful, 45% were unsuccessful and 18% were ongoing at the time of the study (Pritchard 2004: 116).

From the above it is clear that the following evaluation criteria and indicators for success can be used:

- Determining if the entity exited restructuring as a going concern;
- In the event of a subsequent liquidation, determining if the average return to creditors is maximised; and
- Determining if the approved plan was implemented.

## Australia

The Corporations Act of 2001 (Cth) provides for credit relief to companies in Australia through a process called voluntary administration (VA) (Hunt & Handa 2005: 1). Hunt and Handa (2005: 1) state that the objectives are similar to Canada's CCAA proceedings, while Anderson (2008: 111) concludes that the objectives are almost identical to those of South African business rescue procedures. The first objective of VA is to return the company to solvency and, if that is not possible, the second objective is to maximise the return to creditors and members as opposed to immediate liquidation (Hunt & Handa 2005: 2; Anderson 2008: 110). VA aims to achieve these objectives by facilitating a stay on creditor claims in order to provide an opportunity for the company to restructure its affairs for the benefit of creditors and other stakeholders rather than liquidation (Blazic 2010: 2).

An important principle of the VA legislation is the appointment of an independent individual, external to the company, as the "company administrator". The duty of the company administrator is to investigate the financial position of the company and decide on the appropriate course of action (Dal Pont & Griggs 1995: 194). Possible options available to the company administrator are the execution of a deed of company arrangement (DOCA) to rescue the company, or the commencement of liquidation proceedings, which should result in a better return for creditors than the winding up

of the company in the first place (O'Flynn & Mainsbridge 2008: 3–4). The DOCA is a rescue plan (Routledge & Gadenne 2000: 236; Anderson 2008: 124–125) and normally comes to an end when the conditions specified in the deed for termination are met, unless the provisions are not met and winding up commences (Sellars 2001: 8). The DOCA is similar to the business rescue plan of the South African business rescue legislation, which is equally important to the successful outcome of South African businesses using business rescue proceedings.

The legal committee of the Companies and Securities Advisory Committee (CASAC 1998: 1), as well as Anderson (2008: 133), state that the VA procedures are popular in Australia, but do not provide any evidence indicating the actual use and success rate of companies using the proceedings. O'Flynn and Mainsbridge (2008: 2) confirm Anderson's view that the Australian insolvency practitioners are happy with the VA regime, but point out that it is difficult to find hard evidence to determine its success. They state that, due to changing economic conditions, overlapping insolvency administrations (the simultaneous appointment of a receiver and liquidator) and changes to data collection and presentation methods, a numerical analysis is extremely difficult to do.

O'Flynn and Mainsbridge (2008: 3–4) provide some insights and state that the first objective, namely to maximise the chances of a company, or as much of its business as possible, to continue in existence will be reached with the execution of a DOCA in the form of a rescue plan. The second objective, namely the maximisation of the return to creditors and members as opposed to immediate liquidation, is the non-DOCA objective. The legislation allows about a month to conclude a rescue plan in the form of a DOCA. By looking at the number of VAs that result in DOCAs, one can get an idea of the success of VA (O'Flynn & Mainsbridge 2008: 3). O'Flynn and Mainsbridge found that, for a particular month in 2007, only 33% of VAs resulted in DOCAs, with the rest probably being wound up under the second non-DOCA objective. These rates correspond with the view of Sellars (2001: 10), who indicated that, from 1994 to 2001, between 25% and 50% of VAs were successfully converted into deeds of company arrangement, with the bulk of the remainder proceeding into liquidation.

O'Flynn and Mainsbridge make the point that, although the conclusion of a DOCA between a company and its creditors is a statutory outcome, it does not indicate the practical outcome of the DOCA. Their view is supported by the Australian Tax Authority (ATO), which has expressed scepticism about the bare use of statistics to demonstrate the success of VAs. The ATO reckons that success should be measured by the number of DOCAs that were complied with, rather than the number that were proposed and accepted by creditors. Routledge and Gadenne (2000: 247), in an earlier

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study to determine variables that could distinguish successful from unsuccessful reorganisations, also used VAs that were concluded with deeds of arrangement.

O'Flynn and Mainsbridge also make the point that because a DOCA was not executed does not mean that the VA process had failed. It could be that transitioning into a winding up had resulted in a better return for creditors than an outright liquidation (O'Flynn & Mainsbridge 2008: 4–5). The Australian Securities and Investments Commission (ASIC) keeps statistics pertaining to external administration and insolvencies, but only lists the number of companies entering VA, without indicating the number of VAs successfully converted into DOCAs (ASIC 2014).

VA has been in use in Australia since 1993 (O'Flynn & Mainsbridge 2008: 2) and, because the DOCA is similar to the accepted Chapter 6 business rescue plan, the view of the ATO is of importance. Seeing that the VA and the South African regimes have similar goals, the Australian experience indicates the following points to consider in evaluating the success of the South African model:

- The number of accepted business rescue plans should be recorded;
- The number of business rescue plans that are executed with the company returning to solvency or liquidity after the filing of the notice of substantial implementation is important should be recorded; and
- The number of accepted business rescue plans that resulted in a liquidation on the basis of which creditors received more cents in the Rand than they would have received from an outright liquidation should be recorded.

## United Kingdom

In the United Kingdom (UK), companies in financial distress are allowed to restructure their affairs under the Insolvency Act of 1986, which provides for two rescue procedures, namely an “Administration” and a “Company Voluntary Arrangement (CVA)” (Nyombi 2011: 12). The Insolvency Act of 1986 was aimed at the rehabilitation and preservation of viable businesses, as well as offering the ailing company a better chance of survival by allowing it to undergo a reorganisation or an arrangement plan rather than facing liquidation or administrative receivership (Denis & Rodgers 2007: 177; Nyombi 2011: 17). The South African business rescue model reflects the same philosophy.

The administration order (AO) allows for the court or the holder of a floating charge (a type of secured creditor not found in South African law), as well as a company or its directors, to appoint an administrator for the company (Loubser 2010: 172–173). The aims of the AO are, firstly, for the company (and not just the business) to survive as a going concern; secondly, for its assets to be realised for the benefit of

the creditors as a whole; and, lastly, for distribution to secured or preferential creditors (Lightman, Gale & Smith 2004: Appendix 1; Loubser 2010: 181–184). Loubser (2010: 213) states that, because the allowed period of administration is limited to 12 months, it is seen as only a facilitative period for the company to prepare for the actual rescue, which may be achieved by means of a CVA or a compromise with creditors, or even liquidation. However, according to Blazy, Petey and Weill (2010: 27), the outcomes are indeed a CVA or liquidation, but also a successful reorganisation. Blazy et al. (2010: 9) quote 1989 statistics from Homan indicating that reorganisation happens in 8% of cases.

Turning to the CVA, Denis and Rodgers (2007: 177) state that it was introduced as a company-friendly approach intended to be a voluntary rescue process. According to Loubser (2010: 167), the process was initially hardly used due to the absence of a moratorium on actions by creditors, but was subsequently improved to include such a moratorium. The CVA aims to assist the rescue of the ailing company so that it can undergo a reorganisation or arrangement plan before insolvency sets in, in other words, develop and execute a business rescue plan. The above aims, namely to assist the company to survive as a going concern, and the better realisation of its assets through the development and execution of a business rescue plan, are also found in the South African business rescue model.

How successful are AOs and CVAs? Nyombi (2011: 23) states that the uptake of both procedures has been disappointing for several reasons, but mainly the cost for small companies. However, despite the low uptake, the UK Department of Trade and Industry reported that, by the year 1999, 67% of AOs and 75% of CVAs managed a partial or complete survival of the company (Nyombi 2011: 15). After the 2002 reforms, mainly by means of the Enterprise Act of 2002, research done by Frisby (in Nyombi 2011) indicated that returns to secured and preferential creditors had improved from 29.3% to 34.6%, but those of unsecured creditors decreased from 6.7% to 2.8%. Blazy et al. (2010: 31) found similar returns to creditors. They compared the recovery rates for creditors in France, Germany and the UK and found that, in the UK for the period 1998 to 2005, returns to secured and preferential creditors under AO were 37.2%, as opposed to 25.3% under liquidation. Unsecured creditors recovered 3.5% under an AO, as opposed to 9.6% under liquidation (Blazy et al. 2010: 31).

Cook and Pond (2006: 22) compared the insolvency regimes in the UK and Sweden and corroborated the low uptake of rescue regimes as indicated by Nyombi. They quoted statistics from a study by Cook, Pandit, Milman and Mason, who found that 20% of CVAs are successful, measured according to the extent to which they fulfil their plan and continue to trade free of insolvency (Cook & Pond 2006: 35).



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With reference to unsecured creditors, Cook and Pond stress that an unsuccessful rescue will only provide a portion of the debt, whilst a successful rescue will provide a continued relationship with the creditor. Cook and Pond further conclude that, from an economic perspective, it is more important to ensure that the business survives, whether or not the company is preserved (Cook & Pond 2006: 22). However, they gave no suggestion as to how the survival of the business, as opposed to the company, could be formally evaluated.

Couwenberg (2001: 262) considered survival routes through bankruptcy. He found that, as a percentage of the total number of insolvency proceedings, companies that reorganised – namely through administrations, CVAs and receiverships – amounted to 14%, in contrast to the 86% that went into liquidation. In order to evaluate the success of the reorganisation procedures, the reorganisations were subsequently divided into confirmed reorganisation plans that were really liquidation plans, those that were really an asset sale plan, and lastly those that were really a reorganisation plan. Real reorganisation plans were then divided into those that were concluded successfully and those that were not (Couwenberg 2001: 264).

The first indicator of success would then be the number of companies that went into reorganisation, that had a confirmed reorganisation plan that really was a reorganisation plan (as opposed to a liquidation plan or an asset sale plan), and that successfully concluded the plan. He found a success rate of only 2% for those companies entering reorganisation (Couwenberg 2001: 263).

Couwenberg also considered a second indicator of success, namely firms that successfully went through the *liquidation* procedure in which a going concern asset sale was performed. Since a confirmed reorganisation plan could also really have been an asset sale plan, he also considered these asset sale plans together with going concern asset sales under liquidation. This second indicator of the success would then be that the firm (not the company) survived under this going concern asset sale scenario. He found that the firm survival rate in the UK would be increased to 20% if the successfully concluded reorganisation plans were added to successful going concern sales as described above (Couwenberg 2001: 265). Couwenberg's findings are supported by those of Walters and Frisby (2011: 45), who found that the CVA is effective in rescuing companies, but that equally positive results may be achieved if assets are realised through a CVA, even if the company subsequently ceases to exist.

From the above evidence pertaining to the UK, it is clear that the following indicators of success should be taken into account in evaluating the success of a business rescue regime:

- Whether a company successfully concluded a reorganisation plan without re-entering the bankruptcy procedure;

- The return to creditors for a company that went into reorganisation; and
- Consideration of the real asset sale plans, not only for those companies that went into a reorganisation procedure, but also for those companies that went into liquidation.

In the previous section the goals, criteria and supporting indicators were identified. Goals represent the long-term target of the legislation. The attainment of the long-term goals can be assessed through the use of specific criteria, which must be met in the course of attaining a goal. These criteria, as well as a set of measurable indicators of success to support each criterion, are summarised in the next section.

## Findings

The objective of this study was to develop a set of evaluation criteria, supported by success indicators that are applicable to the South African business rescue legislation. The findings are presented below and discussed on the basis of the propositions set.

### Findings linked to Proposition 1: The goals of the rescue legislation are clear

The research data gathered indicate that all the rescue regimes have clear goals for their business rescue legislation. Three universal goals of the various regimes were identified in this study, as summarised in Table 2.

**Table 2:** The goals of the rescue legislation

	<b>USA</b>	<b>Canada</b>	<b>Australia</b>	<b>UK</b>
<b>Goal 1</b> The company must emerge from business rescue as a going concern, and remain economically viable.	✓	✓	✓	✓
<b>Goal 2</b> If goal 1 is not attained, creditors should receive a better return under the rescue regime, as opposed to immediate liquidation.	✓	✓	✓	✓
<b>Goal 3</b> The impact on all stakeholders should be beneficial.	✓	✓	✓	✓

The achievement of goal 1 and goal 2 was very clear from the literature investigated. Legislation in the USA and UK, as well as Canadian case law, recommends the

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consideration of non-shareholder interest, although it is not mandatory to protect these other stakeholder rights. Goal 3 was therefore found to be precatory rather than mandatory (Olson 2010). Goal 3 can only be achieved together with either goal 1 or goal 2.

The research found support for the proposition that clear goals exist for each of the business rescue regimes. These goals are also in line with the goals of the South African Chapter 6 legislation.

### **Findings linked to Proposition 2: There are criteria, supported by indicators, that can be used to evaluate the success of the business rescue regime at company level**

The research data revealed that there is no standard international framework or evaluation tool for the evaluation of business rescue success. Successful reorganisations under a regime are evaluated using different indicators of success.

With respect to goal 1, indicators of success supported the criterion that the company must emerge from business rescue as a going concern, and remain economically viable. One indicator of success was if the company exits the rescue proceedings as a going concern. Going concern was implied by most researchers if the company was not liquidated. The data further revealed that the evaluation of success in the USA was more thorough and that further investigation was done on the going concern entity after some time. The further investigation was done by considering other indicators such as liquidity, debt ratios, profitability and the number of subsequent filings for business rescue. Research in the USA also showed that the performance of a going concern company could be compared to a portfolio of market shares in the long run, an indicator that was not found to be used elsewhere.

Pertaining to goal 2, indicators of success supported the criterion that the return received under business rescue should exceed the return that would have been received from immediate liquidation. If the company is liquidated subsequent to the business rescue proceedings, but the liquidation was in line with the original business rescue plan, some commentators believe that the business rescue procedures were successful if the return to shareholders was maximised whilst under business rescue. In this case the main goal (goal 1) of business rescue legislation was not met, although the secondary goal was achieved.

With respect to goal 3, indicators of success supported the criterion of considering the impact on all stakeholders. Indicators of success such as the decrease in asset size and the evaluation of whether key operations were kept in one company can be used. In some cases success is regarded as the company retaining its core businesses

and performing well after it emerges from business rescue. These cases are in line with the popular conception that business rescue is a ‘place’ where the company with minor financial problems has an opportunity to restructure and ultimately to continue operating as a going concern. If the asset size decreased dramatically or key operations of the company were lost, it implies that stakeholders (i.e. suppliers and employees) were most likely not protected. As indicated earlier, goal 3 can only be achieved in combination with goal 1 or goal 2.

In order to evaluate the going concern entities that emerge from business rescue, the above criteria and indicators of success can be used. The criteria and indicators of a successful business rescue are summarised and presented in Table 3, together with an indication of the particular regime where it was used to measure success.

**Table 3:** Goals and criteria with their relevant indicators that guide the evaluation of success following a reorganisation, restructuring or rescue

	USA	Canada	Australia	UK
<b>Goal 1: The company must emerge from business rescue as a going concern, and remain economically viable</b>				
<b>Criterion: The company should be economically viable on exiting business rescue as well as in the medium to long term</b>				
<b>Indicator 1</b> Number (or percentage) of companies that exit business rescue as a going concern – going concern is implied if the company is not liquidated.	✓	✓	✓	✓
<b>Indicator 2</b> Restored liquidity of company – measured by liquidity ratios.	✓	–	–	–
<b>Indicator 3</b> Restructured debt – measured by debt ratios.	✓	–	–	–
<b>Indicator 4</b> Restored profitability of company – measured by profit margins, return on assets and cash flows.	✓	–	–	–
<b>Indicator 5</b> Return to economic viability – measured by the number of subsequent times the company re-filed for business rescue.	✓	–	–	✓
<b>Indicator 6</b> Compare return received from rescued going concern company to return on a portfolio of market shares or matched peer company.	✓	–	–	–

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	USA	Canada	Australia	UK
<b>Goal 2: Better return to creditors than immediate liquidation</b>				
<b>Criterion: Return to creditors should be maximised</b>				
<b>Indicator 7</b> Determine if the approved plan (to maximise the return to creditors) was implemented.	✓	✓	✓	✓
<b>Indicator 8</b> Compare return received under business rescue proceedings to return that would have been received from immediate liquidation.	✓	✓	✓	✓
<b>Goal 3: Protection of all stakeholders</b>				
<b>Criterion: Consider impact on all stakeholders</b>				
<b>Indicator 9</b> Determine change in asset size.	✓	-	-	✓
<b>Indicator 10</b> Determine if key operations were kept in one company.	✓	-	-	✓

Literature about the evaluation of the success of business rescue in Canada, Australia and the UK was limited, most probably because of the uncertainty about how to evaluate the success. Statistical evidence on the USA was found to be most comprehensive. Because of the long history of the US legislation, more research has been done to date, and this research is seen as the benchmark for most of the other countries.

Based on the criteria identified above, the research found support for Proposition 2 in that criteria, supported by indicators of success, are available and can be used to evaluate the success of a business rescue regime. The possible application of the criteria to the South African Chapter 6 business rescue regime is discussed below.

**Findings linked to Proposition 3: The criteria and indicators can be adapted and applied to evaluate the success of Chapter 6 business rescue in South Africa at company level**

In South Africa, the King reports form an integral part of a company's reporting responsibility. Among other things, companies are expected to be sustainable, show good corporate citizenship and involve all stakeholders in financial reporting. Olson

(2010) confirms that companies are expected to focus not only on shareholder profits, but also on social welfare.

The official unemployment rate in South Africa is 24.1% (StatsSA 2014). Chapter 6 can support the South African government in achieving the macro-economic and social goals for South Africa by reducing business liquidations and thereby preserving the country's levels of employment (Pretorius & Du Preez 2013: 189). The South African Companies Act is unique in the sense that it gives more power to employee groups and trade unions in comparison to the international countries evaluated in this study (Olson 2010). In South Africa, employees can be recognised as creditors; employees must be consulted in the development of the business rescue plan; employees are permitted to address creditors; and employees can buy out uncooperative creditors or shareholders (CIPC 2014). The High Court of Polokwane recently set aside the votes of creditors who voted against a business rescue plan and declared that the plan should be adopted. The court pointed out that the interests of employees should be considered (De Klerk 2014). South Africa therefore has a more holistic approach to business rescue.

The main objective of Chapter 6 is therefore to help the company to continue as a going concern, which will, in turn, help solve the unemployment issue. The secondary objective is to result in a better return for creditors than in the event of immediate liquidation. The main goals of Chapter 6 are in line with the goals of the international insolvency legislation we have researched, but with more emphasis on employee protection. We therefore submit that the evaluation criteria and indicators of success identified from international research can be used in the South African context, as the main goals are the same. Because of the social concerns in South Africa, and taking into account that the Companies Act does give more power to employees than does international legislation (Olson 2010), an additional indicator of success (indicator 11) can be added to the international criteria in Table 3. Indicator 11 would be to measure the number of jobs that have been saved as a result of Chapter 6.

Key insights into how business rescue success could be evaluated at company level in South Africa were obtained from this research. Using these insights we propose a set of evaluation criteria, supported by indicators of success, as illustrated in Figure 1. Our study focuses only on the formal Business Rescue proceedings as described in parts A to D, but since the Companies Act includes the informal compromise with creditors in the same chapter as the formal business rescue proceedings, we indicate both the formal and informal proceedings in the figure.

Figure 1 starts by distinguishing between formal and informal business rescue proceedings. Formal proceedings have the following two explicit goals, and one implied goal, namely:

- A restructured, independent, going concern company; or
- A better return to creditors and shareholders than under immediate liquidation; and
- The implied protection of all stakeholders.

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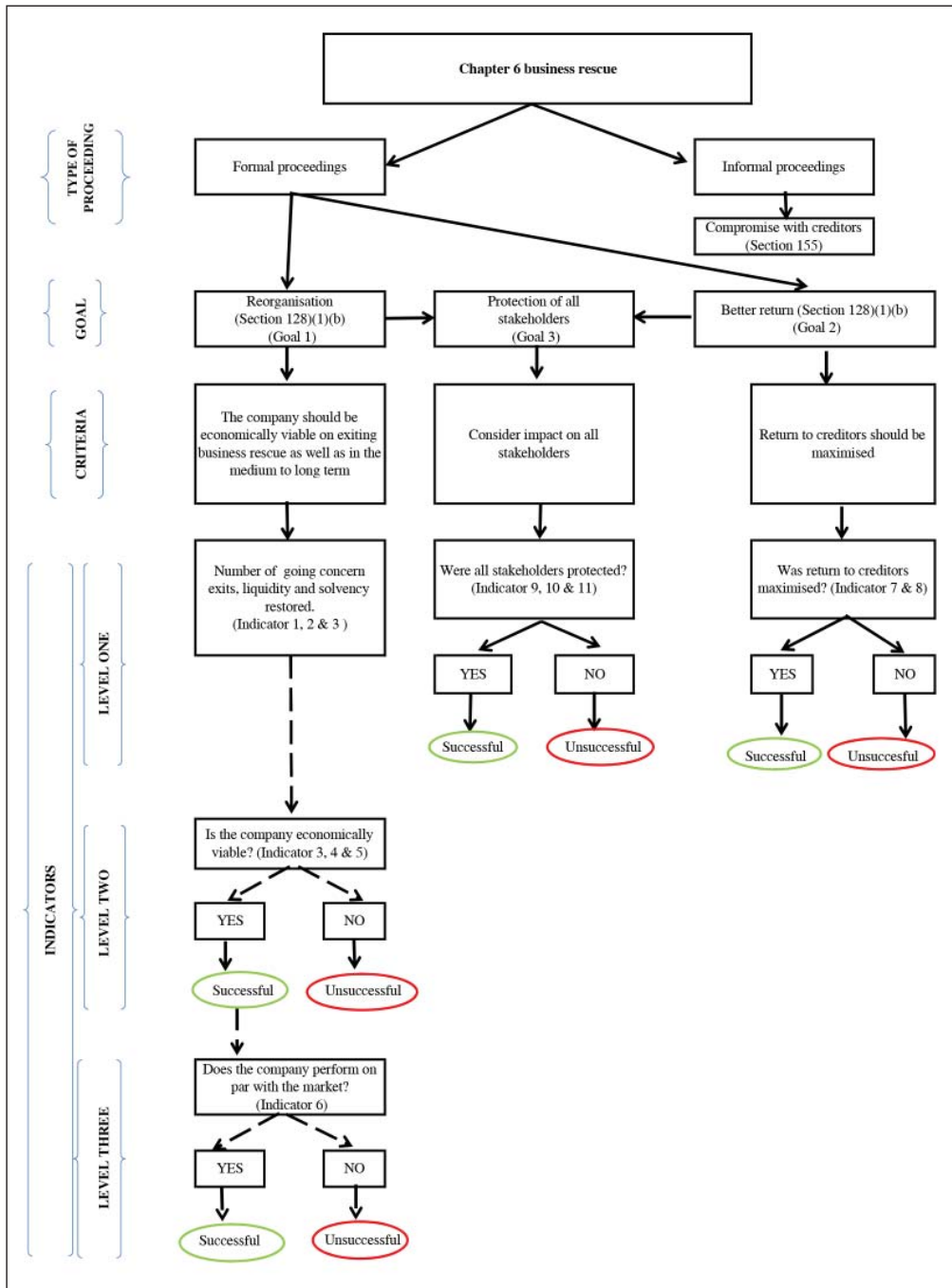


Figure 1: Proposed process for evaluating the success of business rescue at company level in South Africa

Each goal is evaluated by a specific criterion and supported by a number of indicators. These indicators are further divided into three levels. A level one indicator can be used upon exiting the proceedings. Indicators at levels two and three could be applied after some time has lapsed since the initial exit from the proceedings.

Level one represents the first and most basic indicators, namely to determine the number of companies that exit as a going concern and those that have achieved a better return for their creditors and shareholders, either with or without the use of a going concern asset sale. At this level the protection of all stakeholders is also evaluated.

Levels two and three indicate that an important measure of reorganisation success is to determine if the company is economically viable in the medium to long term. The dashed lines in Figure 1 indicate that the performance of the company should be evaluated after some time has passed. The research data did not propose a clear time period, but we submit that a period of three years should be sufficient to determine the economic viability in the medium to long term.

Level two indicators evaluate the success of business rescue by assessing whether the company is economically viable in the medium term. Goal 1 is assessed through the use of indicators such as debt and profitability ratios, as well as the number of times the company subsequently re-filed for business rescue.

Level three indicates that the ultimate measure of reorganisation success is to determine if the company is economically viable in the long run. Since market data are normally incorporated in this indicator, a longer time period is more appropriate in order to reduce the effect of economic cycles on the indicator. Comparable financial information will not always be available, especially not for small and medium entities. For this reason, it is expected that evaluation on level three is unlikely to be performed in South Africa at this stage. If evaluation is done at such a high level, it is expected to be done on listed companies only.

It is important to note that there may be instances where an application of the above evaluation process may not yield a clear indication of success. In such cases judgement should be applied taking into account the goals of the business rescue legislation.

## Conclusion and suggested future research

Given the unemployment rates in South Africa, the expectations from government and the general public for successful business rescues in South Africa is high. Recent statistics on the success of the newly implemented business rescue regime can be questioned in the light of the international success rate. Accurate statistics based on international best practice are needed.



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The research done indicated that, since our business rescue regime has similar goals to the main international regimes, we could draw from the criteria and indicators of success used to evaluate the success of the international regimes to formulate criteria and supporting indicators to evaluate the success of the local regime. It is submitted that the evaluation criteria and supporting indicators that were identified in this article can be used to evaluate the actual success of business rescue attempts in South Africa in an objective manner. The ultimate success of Chapter 6 depends on the company's ability to remain economically viable in the long run, which is indicated by debt ratios, profitability ratios and the number of subsequent times the company filed for business rescue. Since several criteria are considered important, future research may focus on the development of a matrix or scorecard to give proper weight to the different evaluation criteria and supporting indicators.

This paper indicates the importance of properly evaluating the success of business rescue. If we neglect this aspect, then, in the words of Marty Rubin: "Every line is the perfect length if you don't measure it."

## Management implications

The research findings indicated in this paper have management implications for the following affected parties or stakeholders: the CIPC, business rescue practitioners, post-commencement financiers and the Industrial Development Corporation (IDC). The CIPC, as regulator, should require compulsory reporting on the indicators contained in Table 3. Existing data gathered by the CIPC will not support this attempt to evaluate the success of the regime. If the CIPC could collect the necessary information, business rescue practitioners could evaluate their own individual success as opposed to the combined success of all practitioners. Post-commencement financiers such as banks could better assess the risk of providing post-commencement finance to companies under business rescue. The IDC could also better assess the ability of business rescue to save jobs and the company's future ability to positively participate in and contribute to the economy as a whole.

## Limitations

The research that was done had the following limitations:

- Bias from the researchers in their interpretation of the data, as explored in the literature review;
- Timing of research. The research was done within the first four years of the new legislation. Academic research articles on business rescue success in South

Africa were limited, and reliance was therefore placed on international literature and communication with business rescue practitioners and representatives of the CIPC.

- Completeness of literature. Although the researchers made every effort to obtain applicable and relevant international research indicating the evaluation of success of a particular regime, it is possible that some data were missed. The impact of this limitation is somewhat reduced by the fact that sufficient and relevant research data pertaining to the leading corporate rescue regime, namely the USA, were found. The researchers drew comfort from this fact and consider it unlikely that research on some of the other rescue regimes would reveal better criteria for the evaluation of success than those discussed in this paper.

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