

Workshop III: Corporate Law and Insolvency Law
Black Economic Empowerment and Commercial Law Workshop
Thursday 26 August 2004, Sandton, Johannesburg

1 Introduction

Business rescue (BR) and Black Economic Empowerment (BEE) may, at first glance, seem very unlikely bedfellows. Popular wisdom has it that both areas of endeavour are, at the best of times, of rather uncertain outcome, largely unfamiliar in terms of prevailing business culture in South Africa, and challenging when it comes to strategy and execution — as though ‘never the two shall meet’. We endeavour to illustrate that, not only are the two concepts likely bedfellows, but that, given the right environment (legal, judicial, and corporate), ‘the two can meet’.

In this presentation, we briefly explore the two concepts to achieve a common understanding of both their import and scope, and, in the process hope to avoid the myopic view that seems to prevail among latter-day experts struggling to adapt to the emerging business landscape that BR and BEE impose on an established ‘world view’, threatening to disrupt the ordered calm, refuge of a ‘business as usual’ response to the challenge of socio-economic transformation.

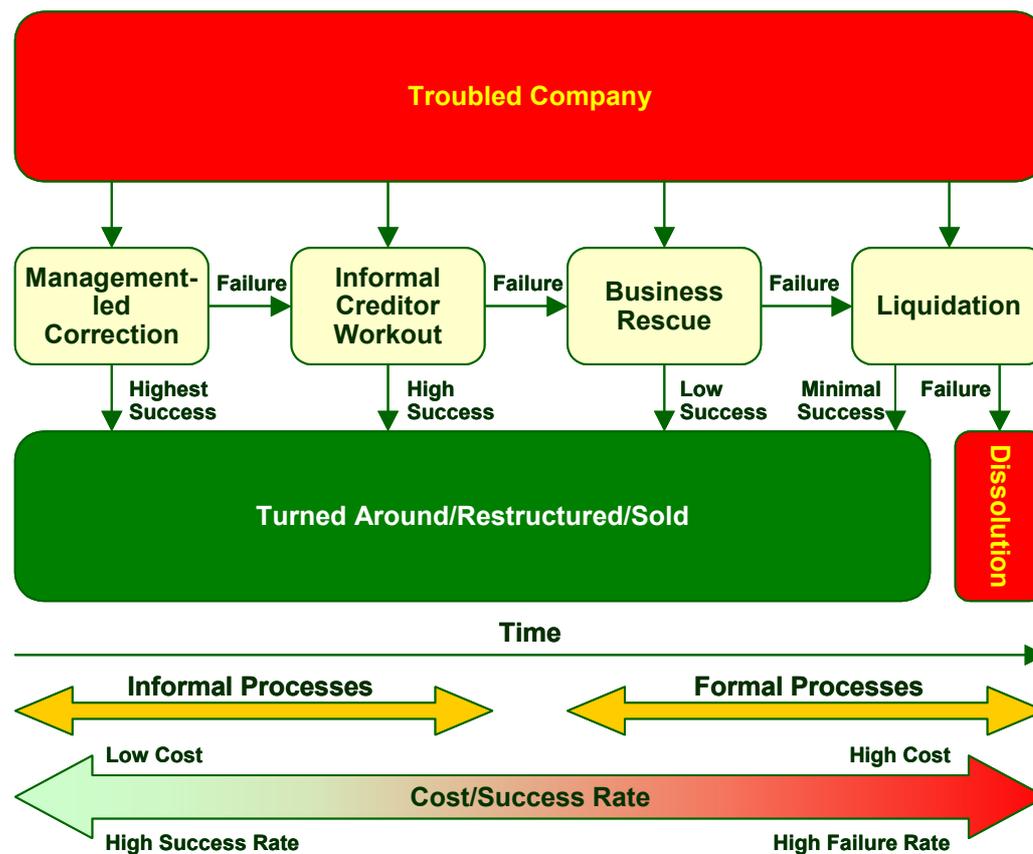
2 Business Rescue

Financial distress is the tangible symptom of business failure manifest to stakeholders both within the company as well as – in its acute form – outside of the company, which, if not attended to promptly and appropriately, leads to an ever increasing rate of stakeholder disengagement from the company. Below is a schematic depiction of the timeline of financial distress.

The timeline of financial distress can be illustrated in a diagram on the following page.

* Managing Director: Corporate Renewal Partners.

Timeline Of Financial Distress



Progression to the right of the timeline entails not only higher resource consumption to achieve a turnaround in the company's fortunes, but also diminishing returns on those same resources up to a point where any incremental investment to salvage the company produces negative returns and the effort must be abandoned. From the above, it is evident that BR is but a sub-set of the business turnaround process, constituting the beginning of the formalisation of the process prior to its being abandoned in favour of the realisation of the residual asset value through liquidation. To the extent that financial distress is not anchored in factors that combine to render the feasibility of recovery non-viable, there are real opportunities to achieve BEE in business turnaround or rescue.

3 Black Economic Empowerment

Black Economic Empowerment, as defined by the Broad-Based Black Economic Empowerment Act (the 'BEE Act'),¹ aims to deliver benefits beyond what can be expected during business rescue. However, in certain respects, BR may render BEE benefits that reach beyond the restructuring of the country's economic asset ownership that is typical of BEE transactions that pursue quantum set by the Act, and thus capture the attention of the media. However, the practice as evidenced in the two transactions announced during the third week in July 2004 seem to indicate that more

¹ Section 1 of the Broad-Based Black Economic Empowerment Act 53 of 2003, accessible at <http://www.polity.org.za/pdf/BroBasBlaEcoEmpA53.pdf>.

can be achieved through ownership restructuring transactions — the most significant of which is the incorporation of incentives to raise productivity and thus enhance the long-term financial viability of the BEE transaction.

Business Rescue, on the other hand, has the potential to contribute to the country's endeavour to restructure asset ownership whilst achieving direct involvement of Historically Disadvantaged Persons (HDPs) in the strategic and operational operations of the asset. These HDPs frequently emerge from the ranks of the distressed company, and are thus familiar with its operations. If they invest in a business turnaround, they join as co-owners and managers of the business from day one. A vital aspect that ensures sustainability is the 'built-in' skills transfer from the turnaround expert to the new HD owner/managers. By definition, the turnaround expert only realises his or her 'up-side' on delivery of a sustainable recovery**.

***Sustainable recovery involves achieving a viable and defensible business strategy, supported by an adequate organisation and control structure.² It means that the company has fully recovered, is making 'good' profits and is unlikely to face another crisis in the foreseeable future.*

4 Black Economic Empowerment achieved through Business Rescue

Two critical differentiators distinguish BEE achieved through BR and make it particularly rewarding:

- BEE in BR is Pareto-superior to current practice of economic asset ownership restructuring transactions as it minimises leakage and avoids upfront sunken costs in deal structuring fees and advisory expenses, thus eliminating 'deadweight losses' which characterise these transactions. (In jurisdictions with an established BR culture, turnaround professionals regularly share the turnaround risk and thereby tangibly demonstrate their confidence in the rescue they lead by sharing the 'up-side' reward with equity owners, rather than take a fee irrespective of outcome); and
- An immediate meaningful involvement and assumption of ownership risk and reward by invested HDPs, whilst
 - Achieving a public good in the preservation of productive assets, which the fiscus through tax regimes taken advantage of by the distressed company has contributed to create, and thus society at large may be deemed to be invested (or at least to hold vested interest) in the distressed business. (Evidently, this is not a direct function of BEE in BR, although a null hypotheses that the HDPs' contribution was historically disproportionate to the reward they received would be difficult to disprove); and

² See Siti Maimun Kamso Wan Rafaei, June Poon Meaw Ling, & Arawati Agus 'Corporate Turnaround in the Manufacturing Sector of Malaysia' accessible at <<http://mgv.mim.edu.my/MMR/8804/880406.Htm>>.

- Minimising the significant risk associated with start-ups and/or green fields projects — which can be expected, all things being equal, to generate equal, if not higher RoE than re-invigorated businesses emerging from a competent BR — because of the historically proven market viability of distressed businesses.
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