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in business and government

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PMR's Editorial philosophy:
"It is only by standing on the
shoulders of giants that I
have been able to see
further."
Sir Isaac Newton,
1642–1727

Company Turnaround

Turnaround and the timeline of financial distress (part II)

Jan van der Walt, CEO, Corporate Renewal Partners

Last week's article described how a troubled company not eventually turned around through four stages – management-led correction, informal creditor work rescue and liquidation.

This article focuses on the first two stages, which are informal processes occurring within the legal framework provided by the Companies Act and Insolvency Act, and planner rescue legislation.

Management-led Correction

The ideal turnaround environment is characterised by the absence of creditor and legal issues other than normal stakeholder management. Accordingly, management initiative and is in control of the turnaround agenda to stabilise, fund and fix the company.

Turnaround under these circumstances has the highest success rate, and typically

- companies where early warning signals of impending distress are recognised and acted upon
- companies experiencing emerging problems that cause underperformance and distress
- distressed companies supported by benevolent shareholders – eg distressed strong groups and organisations in the public sector.

Informal Creditor Workout

Acute and worsening problems impair a company's ability to meet its commitments to trade creditors. This normally leads to creditor intervention. A workout follows an agreement outside the legal framework ie out-of-court settlement between management, distressed or defaulting business, and creditors on a plan to reduce indebtedness.

Directors and management, once making use of a workout process on a forced sale, value their secrecy, avoiding the stigma of a more public formal procedure such as rescue (and avoiding investigation and challenge of directors' conduct).

Management remains in charge, but the turnaround agenda is largely determined by the workout agreement.

Banks cannot participate in the management or intervene in the affairs of a troubled company since the rights of other creditors may not be prejudiced. Yet, banks have considered on how management of a troubled company will compose and conduct its turnaround.

Banks have 'special portfolio', 'credit recovery' or 'intensive care' departments in management structures that place intense scrutiny on a company's position.

Accordingly, a workout is normally triggered and negotiated by a distressed company consortium of its banks rather than by other creditors eg trade creditors who do not have workout skills.

Workouts are not without problems. There is a degree of 'free-riding' by other creditors little by way of solutions, finance and sharing in the risk, but who share in the benefit of a workout be successful. Then there are dissenting creditors, normally the smaller ones, who derail the workout by prematurely reverting to formal insolvency laws.

Yet, workouts have a high success factor. SA statistics are not available, but an

conducted in the UK* found that:

- 75% of businesses successfully emerge from informal creditor workout and a insolvency processes altogether
- the successful 75% are either turned around or they pay their debt by finding banking sources
- the process takes 7,5 months on average
- the remaining 25% of cases enter some form of insolvency procedure.

Turnaround during formal insolvency will be addressed in next month's article, w reference to new business rescue legislation.

*The Cycle of Corporate Distress, Rescue and Dissolution: A Study of Small and Medium Size UK Compar Oren Sussman, 19 April 2000).<http://www.corprenewal.co.za/>

Professional Management Review
PO Box 1200, Parklands 2121
tel: +27 11 880-4720 fax: +27 11 880-4724 email: johanh@pmrinet.com
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