



INSOLVENCY & BUSINESS RESCUE

Misuse of the business rescue process – failure before it begins

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Business rescue was introduced as a mechanism to rehabilitate financially distressed companies and preserve value. In practice, however, it is often invoked only once liquidation is imminent. This article considers how the defensive use of business rescue, rather than its application as a proactive restructuring tool, materially undermines its prospects of success, with many processes effectively constrained before they begin.

Chapter 6 of the Companies Act 71 of 2008 introduced business rescue as a mechanism to rehabilitate financially distressed companies. Its purpose is clear, to facilitate the restructuring of a company in a manner that allows it to continue operating on a solvent basis or, failing that, to achieve a better return for creditors than immediate liquidation.

In principle, it is a powerful and necessary tool for struggling companies. In practice, however, its effectiveness is often undermined by the circumstances in which it is invoked.

In many cases, by the time business rescue is considered, the business is no longer capable of being rescued. A mechanism built for intervention – not reaction – business rescue is designed to operate at the point of financial distress, not financial collapse.

The statutory framework assumes that, while the company is under pressure, it retains sufficient operational substance and stakeholder confidence to support a restructuring process. The moratorium on creditor claims is not an end in itself; it is a tool to create space within which a viable business rescue plan can be developed and implemented.

Central to this framework is the requirement of the "reasonable prospect of rescue". This is a substantive threshold. It requires a credible, supportable basis on which the company can be rehabilitated, whether through operational restructuring, the introduction of new capital, or

a compromise with creditors. It is not satisfied by the mere hope that conditions might improve.

In the current economic environment, that threshold is increasingly difficult to meet. South African businesses are operating under sustained pressure: elevated interest rates, constrained demand, rising input costs and ongoing infrastructure challenges. In this context, financial distress is often prolonged rather than sudden. Businesses absorb pressure for as long as possible, drawing on facilities, extending creditor terms and reducing internal buffers, while the inevitable is looming.

By the time formal proceedings are considered, the position has often materially deteriorated. Business rescue is therefore frequently initiated not as part of a restructuring strategy, but as a response to imminent liquidation. Its immediate function becomes the moratorium – a means of halting enforcement action and stabilising the position.

This is a fundamental shift. A process intended to enable restructuring becomes, in effect, a defensive measure. Where business rescue is invoked in these circumstances, a critical element is often missing: a realistic pathway to rehabilitation.

The underlying business may no longer be viable on any sustainable basis. Liquidity may be exhausted. Access to additional funding (including post-commencement finance) may be limited or unavailable. Creditor relationships may already be compromised. In these conditions, the business rescue practitioner is required to formulate a restructuring plan within a set of constraints that materially limit its prospects of success.

Where business rescue is initiated early and while the business still retains operational stability, there is scope to intervene meaningfully. Funding can be secured, cost structures adjusted and stakeholder support mobilised. The process functions as intended. Where it is initiated at the point of imminent liquidation, the position is fundamentally different. At that stage, the process becomes a futile exercise, and where the restructuring of the business is left with minimal options. The business rescue practitioner then has the unenviable task of managing a business that has largely exhausted any possibility of it being successfully restructured. Value erosion has already occurred, and the ability to reverse such erosion is limited.

The distinction between those two scenarios is often the difference between a viable business rescue and an inevitable failure.

The defensive use of business rescue also shapes stakeholder behaviour. Creditors are increasingly attuned to proceedings that appear to have been initiated to delay enforcement. Where confidence in the underlying viability of the business is limited, support by stakeholders for the proposed business rescue plan is correspondingly weak.

Funders adopt a similarly cautious approach. Post-commencement finance is, by its nature, risk capital (and often unsecured). It is unlikely to be made available in circumstances where there is no clear and credible restructuring thesis. Without stakeholder alignment, the process becomes self-limiting.

These dynamics are amplified by the current economic environment. Recent increases in input costs (fuel crises) have placed sustained pressure on margins across multiple sectors. At the same time, constrained consumer demand has limited the ability of businesses to pass those costs through. The result is a gradual erosion of profitability and liquidity.

Importantly, this erosion is often not immediately visible. Businesses continue to trade, but with reduced financial flexibility and increasing reliance on short-term measures. It is within this environment that business rescue is increasingly being invoked, not at the point of manageable distress, but at the point where that accumulated pressure becomes unsustainable.

None of this detracts from the value of business rescue as a mechanism. Where it is used as the statute intended, it remains a workable option for a proactive and well-considered restructuring strategy. Business rescue remains one of the most effective mechanisms for preserving value in the South African economy and provides a structured framework within which businesses can reorganise, negotiate with stakeholders and, where necessary, compromise debts and gain access to new capital.

The issue is not the tool. It is the timing and purpose of its use.

Business rescue is too often positioned as a last line of defence. In doing so, it is expected to resolve circumstances that have already progressed beyond the point at which meaningful and successful intervention is possible.

The question is not whether business rescue works. The statutory framework is clear, and where properly applied, it is effective. The question is whether it is being used in the way contemplated by Chapter 6.

When business rescue is deployed as a defence to liquidation, or to frustrate creditors rather than as a considered restructuring mechanism, its prospects of success are inherently limited. In that sense, many business rescues do not fail because the process is flawed. They fail

because, by the time they begin, the outcome is already largely determined.



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