



INSOLVENCY & BUSINESS RESCUE

Swimming upstream – the case for assisting the struggling SME

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Whilst there have been a handful of instances where we have been told, genuinely and somewhat accurately, that we've never had it so good, the unfortunate reality is that another widespread saying is, more often than not, applicable: times are tough, and they will likely stay tough, or worsen.

There is little doubt that the South African domestic economy is in a bad shape. Unemployment is high and increasing, with government warning that more jobs are at risk. There is persistent talk of an impending financial crisis and a looming fiscal cliff. Growth and public services remain constrained by what is often referred to as unsustainable debt levels. The words "anaemic" and "growth" are now joined at the hip.

Small businesses are suffering. The Daily Investor reported at the start of August that over half of 1600 small businesses canvassed, feared failure within a year as they stagger under the weight of increased costs, with only one in four such businesses reporting growth – the rest are presumably treading water, or contracting. The OECD reported that the percentage of non-performing loans is on the rise, and particularly pronounced for small and medium-sized businesses, with no realistic reprieve on the horizon.

Small to medium-sized businesses (SME's) are often the canaries in the coal mine: they tend to feel the pinch first, and are often sandwiched between a lender / financial institution, and non-paying customers. In times of economic slowdowns or even downturns, the resources of businesses throughout the supply chain become stretched, payments begin to lag, and debtors' book balances begin to rise. This in turn puts significant pressure on SME's, which often respond by turning a blind eye to ever-increasing delays in receiving payments, even though their lenders will not necessarily do the same.

It is also a reality that a SME may be anxious to maintain existing commercial relationships and retain customers that have been acquired and built up over many years, and is thus hesitant to get tough with non-paying customers. This is particularly so when the SME's debtors' book is comprised of a substantial number of relatively smaller amounts, with the often-mistaken belief that doing nothing and waiting for payment, costs less than taking active steps to recover payments. This approach is often more hopeful, than realistic.

Whilst this approach may seem to be commercially savvy and noble, the giving of leniency cannot be to the detriment of the SME, especially where the financial institution starts to harden its stance. It is at that point that directors of SME's should abandon the soft approach to non-paying customers and clients, and should instead seriously consider taking more formal steps to ensure or hasten payments: it is difficult to justify an approach which prioritises the maintenance of an existing commercial relationship with a defaulting customer, over your company's obligations to make payments to its bank. This may result in financial institutions taking steps against your company to exercise security rights under mortgage bonds, notarial bonds, and cession of income and debtors' books, and to call on sureties (often directors and/or shareholders) for payment (or even to consider the liquidation of your company).

What can SME do when there is a danger of feeling the pressure from both ends? Engaging legal assistance as early as possible may well avoid serious consequences down the line, and will maximise the prospect that the SME can protect and enforce its rights. This can start with a review of the existing payment terms applied by the SME, and small adjustments to the SME's daily operations, contractual provisions and terms of trade, which may reduce the frequency of defaulting customers.

Where there are defaulting customers, attorneys can direct correspondence, demands and contractual breach notices to them. Often, when the defaulting customer is faced with a formal demand on a lawyer's letterhead, payment is forthcoming, or at least a payment arrangement is put in place. Attorneys can assist in preparing and monitoring the payment arrangement / agreement, and catering not only for the costs of the attorneys' involvement, but also for the consequences of breaches thereof. A formal payment arrangement / agreement will likely include certain acknowledgements by the defaulting customer, which should reduce the time and costs of any subsequent litigation.

Attorneys can also put in place additional security, from the defaulting customer, in favour of the SME, to increase the SME's likelihood of recovery. If all steps to recover payment fail, then attorneys can assist in instituting legal proceedings in order to recover payment (including legal costs) and to exercise security. These are often formal, Court-based processes, but can include or be preceded by roundtable negotiation, informal mediation, and arbitration, in an attempt to avoid the cost and time associated with Court proceedings. The prior work done for the SME by the attorneys will stand the company in good stead in all such proceedings.

It is not rare for struggling, defaulting customers, to seek the protection provided by business rescue proceedings. Abuse of these proceedings (which immediately places a moratorium on legal proceedings against the defaulting party, but requires the supplier to continue to perform its obligations) is not uncommon, and is a frustration that may result in a decreased recovery, months later, from the defaulting party. A SME will need the expertise of attorneys to assess the legitimacy and viability of business rescue proceedings, and to guide it through the process and negotiation that ought to lead to the implementation of a business rescue plan and payment to creditors. At the extreme of the spectrum, a business will need attorneys' advice should the defaulting customer go into liquidation (or even if the business needs to consider seeking the liquidation of the defaulting customer), and for the subsequent claims process.

Engaging attorneys to facilitate in recovery is often seen as an unnecessary expense, but in reality is a step that not only can save money in the long term, but one that protects the lifeblood of a company: its cash flow. The need to take sound legal and financial advice is an imperative, and businesses should do so at the earliest possible opportunity, and not wait until it is too

late. Seeking legal advice, early on, in order to take prudent steps to protect the business, is crucial, especially when the economy is and will remain strained.



Brendan Olivier

Director

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