Business Rescue, Turnaround and Retention for SMME&C’s

Revised Report 2 of 2

Small Business Distress and Recovery Strategies

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### ABBREVIATIONS AND ACRONYMS

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<tr>
<th>Abbreviation/Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>ACO</td>
<td>Assessment of Company Opportunity</td>
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<tr>
<td>ADR</td>
<td>Alternative Dispute Resolution</td>
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<tr>
<td>BA</td>
<td>Business Advisor that focuses on development and retention</td>
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<td>BR</td>
<td>Business Rescue</td>
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<td>BRE</td>
<td>Business Rescue Event</td>
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<td>BRP</td>
<td>Business rescue practitioner</td>
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<td>BRiL</td>
<td>Better Return than in Liquidation (S128(1)iii)</td>
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<tr>
<td>CIPC</td>
<td>Companies and Intellectual Property Commission. CIPC is also referred to as the Regulator.</td>
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<td>CASP</td>
<td>Comprehensive Agriculture Support Program</td>
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<td>DA</td>
<td>Distress Advisor who can identify distress and bring to the attention of forums</td>
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<td>DC</td>
<td>Distress Charter</td>
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<td>DSBD</td>
<td>Department of Small Business Development</td>
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<td>DTI</td>
<td>Department of Trade and Industry</td>
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<td>DoL</td>
<td>Department of Labour</td>
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<td>DPW</td>
<td>Department of Public Works</td>
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<td>PCF</td>
<td>Post Commencement Finance (funding)</td>
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<td>NSB Act or NSBA</td>
<td>National Small Business Act</td>
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<td>QRPA</td>
<td>Quick Reasonable Prospect Assessment</td>
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<td>RP</td>
<td>Reasonable Prospect</td>
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<td>SB</td>
<td>Small Business</td>
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<td>Abbreviation</td>
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<tr>
<td>SE</td>
<td>Severity evaluation</td>
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<td>SCCL</td>
<td>Specialist Committee on Company Law</td>
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<td>SMME</td>
<td>Small, Micro and Medium enterprises</td>
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<td>SMME&amp;Cs</td>
<td>Small, Micro and Medium Enterprises and Cooperatives</td>
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<td>TAS</td>
<td>Turnaround Situations</td>
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<td>TP</td>
<td>Turnaround Professional</td>
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<td>TMA</td>
<td>Turnaround Management Association – SA chapter of the International body</td>
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<tr>
<td>ZoI</td>
<td>Zone of Insolvency</td>
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## DEFINITIONS AND EXPLANATIONS

<table>
<thead>
<tr>
<th>Term/Concept</th>
<th>Description</th>
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<tr>
<td>Appointment of BRP</td>
<td>A firm that voluntarily files for rescue appoint the BRP. Alternatively a court may appoint a BRP. Thereafter licencing must be completed.</td>
</tr>
<tr>
<td>Business</td>
<td>Interchangeably used with firm, organisation, enterprise, company or venture.</td>
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<tr>
<td>Distress Charter</td>
<td>Meaning the pre established “agreement” to pursue collective responsibility for a distress response in SMMME&amp;C’s within the economic cluster</td>
</tr>
<tr>
<td>Licensing of BRP</td>
<td>Following appointment, an application for an “ad hoc” license is submitted to the CIPC</td>
</tr>
<tr>
<td>Opinion</td>
<td>Opinion is often not fact based and highly variable. These were obtained during interviews of various kinds with different subjects representing different relevant groups.</td>
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REPORT OUTLAY

This report is the second part of the research has as its main aim to report on the status quo of the SMME&C sector in SA, its key governmental stakeholders, their feedback during the research and secondly, to propose strategies for the different business types. It builds on Report 1 which was aimed at firstly understanding the status and theory of small business distress and recovery outside and within Chapter 6 (business rescue) as regime.

Compilation of reports – Core content

- Report 1
  - Introduction
  - Terminology and concepts
    - Failure
    - Decline
    - Turnaround related
    - Business rescue

- Report 2
  - Introduction
  - Status quo description
  - Strategies
    - Rescue
    - Turnaround
    - Retention
Chapter 1
Is a brief reiteration of the brief from the principal and consequent approach in short. It refers shortly to the research methodology.

Chapter 2
Description of the industry by elaborating on the status quo situation that considers binding constraints and accelerators for turnaround and business rescue in association with governmental interventions.

Chapter 3
Proposal on a Distress Charter for the industry to address the main binding constraint and a proposal to use the Forum principal to govern interventions required by the strategy plan interventions.

Chapter 4
Explores the assessment of distress that in the required first step that must be executed by the forums. The QRPA process is crucial to trigger the relevant strategies to pursue.

Chapter 5
Proposed the key document to drive decision making namely the Intervention Strategy Plan (ISP).

Chapter 6
Report the key strategy initiatives that are proposed to any forum for consideration.

Chapter 7
Summarises and concludes.
Process and structure of Report

1. Introduction and research method (Chapter 1)
2. Industry Status quo description (Chapter 2)
3. Establish Charter (Chapter 3)
4. Forum Governance (Chapter 3)
5. Assess Distress and verification (Chapter 4)
6. Intervention strategy plan (Chapter 5)
7. Initiatives to consider (Chapter 6)
8. Summary and conclusions (Chapter 7)
EXECUTIVE ABSTRACT

Report 1 has identified the relevant associated issues that drive and restrain the turnaround and BR industry with specific relevance to the SMME and the cooperatives sector. It explains that business rescue may be regarded as an effective formal turnaround procedure despite its early “childhood” problems. Regardless of some restraining forces, it appears to save jobs and businesses similarly to that achieved by international regimes.

Report 2 reported the findings as a status quo situation of the SMME economic sector. It applied the strategy consulting process by stating the situation (from findings) and thereafter proposing some potential strategies for the application.

At this point it is important to recognise that the proposal contains generic process steps as it is not possible to address the unique environmental contexts for each individual venture under consideration.

Report 2 proposes that a Charter be established to govern the intervention processes. The Charter governs the Forum concept that addresses the acumen paradox specifically. Additionally it has several benefits for enhancement of both more and better viability of ventures.

Guidelines for the forums to enhance decision making is proposed. It specifically proposes the quick reasonable prospect analysis (QPRA) as central to the operations of the forums. Especially forums must respond to the unique distress situations and consider the level of analysis for the different levels of micro, small, medium and cooperatives.

The key content of Report 2 includes inter alia:

1. Background and industry analysis
2. The research process.
3. The status quo view on the industry
4. Proposal on Charter and Forums principle
5. Intervention strategies proposed for each level of business
6. Assessment processes that may assist assessors to determine the appropriate strategies
SMALL BUSINESS DISTRESS AND RECOVERY – BACKGROUND AND STATUS QUO

Chapter 1
1. BACKGROUND FOR UNDERSTANDING THE CONTEXT OF THE RESEARCH

1.1. Brief restatement of the context of the research

The research has been conceived and commissioned by the DSBD (Department of Small Business Development) with the following specific guidelines (but not limited to):

Terms of Reference requires:

1. Engage industry stakeholders and
2. Investigate strategies for SMME’s and cooperatives to achieve and apply by stakeholders. These are categorised as:
   a. Rescue strategies
   b. Turnaround strategies
   c. Retention strategies

![Components of the brief](image)

**Figure 1.1 The research delimitations**

By default, the brief guided the research approach to focus on addressing the requirements of SMME’s and Cooperatives to survive distress and thereby add to economic growth and employment creation. However, it was not possible to separate
the SMME&C strategies from that of the stakeholders. Therefore Chapters 3 deals with the Charter prerequisite and Forum concept while Chapter 4 focuses on reasonable prospect that will inform the process.

In this document, the word “venture” is often used as synonym for SMME or Cooperative.

1.1.1. Brief methodology of the research

In this section, the applied research process is briefly described. This is necessary to ensure validity of the data collection for Report 2 and the analysis and interpretation thereof. The governing principle of the research design was to optimise “triangulation” (multiple sources of data) as to ensure no oversights. The previous and next diagrams show the process agreed upon by the DSBD committee on appointment. As the brief required, the study focus is on business rescue, turnaround and retention at the various small business levels.

1.2. Underlying philosophy of researchers

The research followed a philosophy of the dialectic conversation. This means that during interviews the interviewees were challenged by statements and opinions only after they offered their initial opinions on the interview questions. The different researchers in the team then entered into a similar conversation to triangulate the data collected.

1.2.1. Research focus of Reports 1 and 2

Figure 2.2 depicts the focus of the study. It shows the requirements to address retention of SMME&Cs and address turnaround (including rescue), to assist them to remain active in the industry.
1.2.1.1. Data obtained from stakeholders to inform the research

Report 2 depended largely on stakeholder inputs. These were obtained through an interview process. A protocol was designed to initiate the semi-structured interview process and ensure consistency. Stakeholder inputs were obtained from individuals at various management levels and experience within the economic cluster. This allowed for helpful information to pursue more in-depth investigation.

To pursue trustworthiness, the draft document was widely distributed to members of the committee as well as the cluster.

Figure 2.2 The research design within the relevant context that was pursued by this research. Note the research focus.
Small Business Distress and Recovery –
Industry status quo description

Chapter 2
2. THE INDUSTRY STATUS QUO

Turnaround procedures involve going beyond the normal managerial responses to business troubles. Therefore, a business in distress may not necessarily require a turnaround response if during the ordinary course of business, it's troubles will be resolved. It is useful, therefore, to see turnaround as a major intervention necessary to avert eventual failure of the company. This may operate through informal mechanisms as well as formal legal processes.

2.1. The restructuring industry

The restructuring industry worldwide is often referred to as complex as it intersects with insolvency law and practice with no “one fits all” process. Nowhere is it better described than by Professor Arnold, in 1943 quoted in the next figure. He describes all the elements to be considered in reorganisation. Although Professor Arnold is focused on corporate firms, experience has shown the same can be said about SMMEs in distress. It is accepted that SMME&Cs do not share the same difficulties as corporates, therefore, dealing with distress may require a different approach.

Arnold (1943) on orgies and paradoxes

* “The ritual of corporate reorganization... is perhaps the most interesting of all our legal rituals from a ceremonial point of view, because it is the most complicated mystery of all... [It is] a combination of a municipal election, a historical pageant, an antitrust crusade, a graduate-school seminar, a judicial proceeding, and a series of horse trades, all rolled into one - thoroughly buttered with learning and frosted with distinguished names. Here the union of law and economics is celebrated by one of the wildest ideological orgies in intellectual history. Men work all night preparing endless documents in answer to other endless documents, which other men read in order to make solemn arguments. At the same time practical politicians utilize every resource of patronage, demagoguery, and coercion beneath the solemn smoke screen. Although to the casual observer the complications seem most forbidding, actually the dialectic of this process is very simple. It consists in the endless repetition in different forms of the notion that men must pay their debts, in a situation in which neither men nor debts in any real sense are involved.”
We proceed to describe the stakeholder interventions based on the research of documents, web sites and interviews for all the members of the economic cluster and beyond.

2.2. Stakeholder interventions in the sector

Roles of stakeholders vary. Stakeholders as defined by the participants in the “Economic cluster” contributed with different inputs as well as different levels of input. The types of inputs are mainly two-fold namely:

2.2.1. Financial resource inputs

The aim of these resources is funding and access to funding. Typically done through NEF, SEFA, IDC, DBSA.

2.2.2. Non-financial resource inputs

The aim of these resources is to support and develop human capital, infrastructure, production capacity, create access and cooperation between participants and industry. Typically done by SEDA, DTI, DoL, DPW, Productivity SA etc or in temporary joint structures.

2.3. Generic SMME&C growth principle framework

Presented in the next diagram is a single presentation of the SMME&C restraining and driving forces which was also confirmed by interviewees during this research. While distress is generally attributed to unique circumstances of the individual venture, these are some generic forces that all SMME&Cs may face during a life time.
2.3.1. Restraining forces

Restraining forces are those that hamper the growth of the venture and may originate externally (strategic origin) and internally (operational). These forces are reiterated as it is crucial for the strategy chapter to follow. Strategic factors often influence product/service demand as well as being outside of the control of the venture.

2.3.2. Driving forces

Driving forces have to do with factors that determine the existing outcomes as pursued in the mandates of role-players. It closely intersect with “intangible” forces (assets) such as education, operationalising a business, cognitive action, entrepreneurial motivation, entrepreneurial skills and business skills of the entrepreneur.

Both restraining forces and driving forces have direct impact on reasonable prospect which is the main theme of Chapter 4.
2.3.3. Entrepreneurial capacity in failure

It is critical to understand that SMME failure originates from entrepreneurial inability to respond to external and internal demands associated with sustainable operating of the venture.

A Key Observation

Finance (or access to finance) is not the real issue as many people believe. The reality is that a feasible business plan (or rescue plan) will unlock access funding any day. Therefore the importance of the reasonable prospect assessment later in the document.

Sustainable impact of financial resource inputs remains problematic for performance monitoring

For the purposes of this report, a key distinction should be made between start-up failure and business failure. While both inevitably result in the foreclosure of a business, there is a contrast in the nature of failure. First off, SMME’s are driven by profitability and stable long-term value, while start-ups are focused on top-end revenue and growth potential. Seven to nine out of ten start-ups (depending on country) will fail however, this may be regarded as a natural failure rate. Therefore, it is critical to distinguish at this point the difference between entrepreneurial failure and business failure. While entrepreneurial failure can certainly induce business failure the converse cannot. The notion of turnaround however only applies to business failure and cannot be used to prevent start up failure.

2.4. Introduction to the status quo findings
This section gives an industry perspective and builds on the previous section where the generic distress framework was presented. Within the industry and based on the findings several constraints and accelerators have been identified. Only the five key constraints and accelerators are explored.

2.4.1. Binding constraints

The fragmentation effect appears to be experienced by most interviewees but is also not unknown to most officials. However, it limits actions of collaboration between stakeholders. Fragmentation refers to “working in silos” while different sector members needs the same information and cooperation which unfortunately does not happen.

Given the high level tacit knowledge (related to competence) and business acumen required as competencies by advisors, the officials themselves as well as appointed external advisors lack these in general. It appears that some of the relevant advisor skills were identified in the Productivity SA system but they also acknowledged it as a constraint.

Fragmentation effect is characterised by low levels of coordination, cooperation, alignment and sharing of information by the relevant participating stakeholders. Most interviews highlighted this problem to exist despite it being acknowledged by rolepayers.

Fragmentation is not blamed on anyone – It must be acknowledged as the “nature of the beast” suggesting alternative seeking within the “COMPLICATED” nature of the governmental structures.
Interviewees reported that there appear to be sufficient resources (financial and non-financial) available to assist SMME&Cs to address their development needs and shortcomings. Simultaneously, the pressure on stakeholders comes from measuring how much resource inputs they achieve. This “push effect” creates situation where more and more non-feasible ventures are funded leading to more and more distressed ventures and failures – this is referred to as the resource-feasibility paradox and which is explored further in Chapter 3. “This has led to throwing more good money after bad businesses” as was stated by one interviewee.

Also reported is the absence of a “philosophy of enterprise development” rather than just executing mandates to achieve measured goals. This may be due to several shortcomings and addressing this will require a significant concerted effort as it involves a culture change within stakeholder operations. It will have to go hand in hand with intensive general business training for officials, especially in turnaround and rescue for specific stakeholders. Within this category of constraints is included the absence of aftercare and measures to support more than “financial inputs”. It is clear that this capacity appears absent from the capacity of the the departmental structures and advisor skills and competencies.
Standardised tools to measure and determine the status of the businesses supported appear absent. These may include existing tools such as opportunity-, reasonable prospect-, going concern-, feasibility-, viability-, due diligence- and likelihood of liquidation\(^1\) models. Commercial banks have extensive tests that they apply. While advisors are required to have access to such tools, these is limited (see fragmentation above) while application and collaboration for its use coordination.

2.4.2. Accelerators

The governmental system and stakeholders are governed by policies as well as the mandates, visions, missions and core business statements that appears to be being pursued by the different stakeholders.

There are initiatives specifically addressed to improve selection of external advisors to address the skills gap reported. There are also many initiatives undertaken by the various stakeholders. However, the effects of these appear in isolation.

Individual stakeholders reported various processes and initiatives that are working well including: individual data bases, software such as CASP (Comprehensive Agriculture Support Program), small business register, gazelles program, NEF post investment monitoring, diagnostic analysis exercise undertaken by SEFA, extension recovery program etc.

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1 Rosslyn-Smith, R, 2017. PhD under examination titled: A liabilities approach to the likelihood of liquidation in business rescue
A Key Observation from the figure above, is that focus must steer towards finding “better” rather than pursuing “more”

The challenge is therefore not to only increase the number of economically active businesses (enhanced number of start-ups) – this appear to be achieved but it faces the resource-feasibility paradox. What is central to this report is to address the quality of businesses, thus finding better business to support and grow thus retention. Proactivity is presented as a prerequisite for turnaround while rescue more reactive.

Evaluating distress has the same purpose namely to identify “better” venture to support in turnaround of business rescue.

2.4.3. Turnaround and Business Rescue status

The initiation of this research pre-empts the conclusion that very little if any systems, processes and initiatives that address turnaround and business rescue do exist currently within the economic sector.

This was confirmed by the research.

However, there exist some systems aimed at evaluation processes to retain businesses across sector members. Simultaneously, the constraints (especially fragmentation) mentioned above do hamper the execution thereof. Much of these are advisor dependent as one criterion to enter the current advisor databases (ex. SEFA and Productivity SA) is to prove that the advisors have access and mastery of the use of such processes. The principle of the system to use this “non-prescriptive” approach leans towards flexibility and variation but appears to have limitations. The main limitation of pursuing flexibility is that there is no universal application standard for stakeholders. This leads to no accumulation of skills within the stakeholder departments – thus aggravating the skill deficiencies instead of improving them.
Literature has shown that an inherent problem to distress and operating in the Zol is absence of early cognition. Previous business rescue research\(^2\) and this research has again confirmed it in practice within the South African environment.

Therefore, the principle of regular monitoring that can inform management is essential.

2.4.4. Business rescue – Chapter 6 relevance

The research indicates that there is little application of Chapter 6 business rescue for small and micro business as well as the cooperatives.

The next diagram shows typically the relevance (not statistically proven) of formal business rescue, informal turnaround and retention within the the different categories within the SMME&C industry in SA. The likelihood of theses interventions is presented as follows.

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\(^2\) Pretorius, 2015. Business Rescue Status report to CIPC.
From the above it is clear that the BR is considered more relevant for bigger business and not at all for the cooperatives. Turnaround has more application value for SMME’s as it affords some flexibility for responding.

This figure highlights the point that Chapter 6 requires some revisions to include these businesses in the use of the legislation. Specific adjustments are required to increase access for the smaller forms of business.

2.5. Chapter summary

The status quo of the SMME&C industry in South Africa bears similar characteristics as most developing countries. Simultaneously, the government has many programs that highlight the associated development of SMME&Cs by resource injection. Additionally, redress of past discrepancies is high on the mandate priorities. This resulted in a push strategy to enhance resource dissemination leading to the resource-feasibility paradox. The DSBD therefore initiated this research to propose strategies to address business rescue, turnaround and retention of SMME&C.

This chapter expanded the specific findings for the environmental status of the industry by reporting the binding constraints and accelerating factors faced by the industry.

The accessibility of formal BR in Chapter 6 was highlighted to indicate the requirement of amendments to assist smaller ventures.
Small Business Distress and Recovery Principles

Chapter 3

Requirement for a Distress Charter and the Forum concept

Process and structure of Report

- Introduction and research method (Chapter 1)
- Industry Status quo description (Chapter 2)
- Establish Charter (Chapter 3)
- Forum Governance (Chapter 3)
- Assess Distress and verification (Chapter 4)
- Intervention strategy plan (Chapter 5)
- Initiatives to consider (Chapter 6)
- Summary and conclusions (Chapter 7)
3. Distress Charter and Forum Concept as Prerequisite for meaningful progress

Considering the main constraint for stakeholder within the industry, there is a need to address fragmentation, improve resource utilisation and establish “collective responsibility”. While this report cannot be descriptive nor have the power to dictate, it proposes the Charter be accepted as a principle and thereafter be initiated and developed.

3.1. Establishing of the Distress Charter (DC)

The Charter addresses the main concerns of stakeholders. It is a proposed initiative to assist all SMME&Cs who are beneficiaries to the services of the stakeholders as well as the stakeholders themselves.

3.1.1. Distress Charter – What is it?

The Charter is an agreement of cooperation and coordination between stakeholders to address fragmentation effects (See also Sub-section 2.4.1 on binding constraints). It suggests a structure to take responsibility for enhanced collaboration and information sharing to enhance the operational efficiencies.

This proposal is not prescriptive to establish a new structure. The relevant structure may be an existing structure with extended mandate to fulfil this role towards distress actions within the economic cluster.

The proposed structure could be the existing Coordination body within the economic cluster to extend its current operations to address the specific needs for addressing distress within the industry – Therefore the concept of DC.

3.1.2. Motive for establishment of the Distress Charter

Considering the aims of the Charter, the following serves as its aims and actions:

3.1.3. Aim and actions of the Distress Charter
The Charter is established as a vehicle for cooperation and integration with broadly the main goals that the Charter must pursue include:

3.1.3.1. Enhance collaboration within and between stakeholders

3.1.3.2. Information gathering

Lending to SMME’s in the private sector is typically conducted through local “relationship” managers, after which routine monitoring and risk assessments of the debtor is carried out. If the performance of a business is flagged as underperforming or in distress, the debtor is usually transferred to a central ‘intensive care’ unit. Within this unit specialist staff act with a single objective of turning business operations around. If after a preliminary evaluation the debtor’s situation deteriorates under generic remedies, then an independent business review is requested. The function of that review would be to build a bridge between the state funder and the troubled company’s management in order to find a solution – which might or might not be using business rescue. The whole process, in terms of creditor concentration theory, amounts to an information-gathering exercise initiated by the concentrated creditor that generates benefits for other creditors in terms of improved quality decision-making.

3.1.3.3. Address fragmentation

3.1.3.4. Enhance information sharing

3.1.3.5. Improve the efficiency of current resource application

3.1.3.6. Create forum guidelines to support individual SMME&G projects

3.1.3.7. Bring alignment between and within participants

3.1.3.8. Role clarification and directives to participants

3.2. Establishing of the Forum concept

3.2.1. Forum – what is it?
Forums are small bodies of 3-5 persons that have know-how and information access to guide the affected/selected SMME&C in remaining a going concern. Participants represent certain stakeholders that contributed (or will contribute) resources to the venture and therefore assist in the responsibility, accountability, and governance triangle. These bodies are made up of stakeholder representatives who are relevant for financial, other, industry-specific inputs.

Forums are similar to what is used by Productivity SA for decision making in a turnaround project. Typically, they play the role of a board of directors which are virtually absent from the SMME&C industry in its totality.

Forums can be responsible for more than one SMME&C (See Forum Structure – Compilation)

Its function is advisory and access to acumen, thus they can "contract" a specific acumen when required from pre-vetted external acumen providers.

The forum is also key to pursuing the regular monitoring principle.

3.2.2. Motive for establishment of the forum concept

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Underlying the establishment of forums is a two-fold paradox. First, the resource-feasibility paradox (See also Sub-section 2.4.1). As shown in the diagram, practice has reported that it is continuously happening and leading to downstream problems. Second, the acumen paradox is highly relevant as seen the two diagrams to follow. Lastly, the forum ensure transparency leading to objective decision making.

The forum is the first step in addressing this paradox. It does so by changing the focus of the resource input while simultaneously addressing the feasibility problem. Chapter 4 expand on the strategies to be pursued.

The underlying driving motive of every forum is targeted to direct the specific challenges of a specific SMME&C when appropriate, such as when applying for support, to enter a value chain, participate in a larger project, require additional resources etc. It functions on a “project basis”.

**Resource feasibility paradox**

- **Resource input drive**
- **SMME feasibility decrease**

In the belief that entrepreneurship and small business development is the silver bullet to improve economic growth and employment there is significant resources/funding available. Large amounts of especially financial resources are directed into SMMEs.

While the stakeholders want to increase resources unfortunately they “fund” more and more fallible ventures as there are only less feasible (fundable) businesses with reasonable prospect that can successfully utilise the resources.
The next figure explains the acumen paradox.

Every forum thus has as its aim to address the paradoxes. This can be achieved through the following routes:

- Development of the strategy initiative plan – (See Chapter 5)
- Establish regular monitoring system
- Decide on TP, BRP or consultant
  - Selection of the BRP
  - Selection of the TP
- To identify and access acumen as resources
- To establish / enhance generic governance
- To direct and improve development of SMME&G management
- To develop accountability – both SMME and stakeholders
- To access new opportunities
- To pursue innovation and alternative value models
• To apply reasonable prospect for turnaround or BR
• To develop relevant venture score-cards
• To scale operations
• Other

3.2.3. Aim of Forum

In line with the Charter aims and actions, the output pursued for each forum is direct decision making for the relevant venture to ensure it remains a “going concern”. This it pursues through regular (quarterly) meetings and ratification of the following:

3.2.3.1. Continued and regular reasonable prospect assessment

The regular determination of reasonable prospect becomes a systematic application to ensure viable businesses and early detection of potential future distress.

Early detection is absolutely critical to meaningful responding to distress. It allows for turnaround to be pursued rather than rescue.

It is therefore critical to have regular forum meetings that can establish regular intervals for the monitoring process.

3.2.3.2. Going concern decisions of relevance

The reasonable prospect determination is also relevant for the going concern determination while it acknowledges the existence of illiquidity versus technical insolveny.

3.2.3.3. Overall strategy changes for improved effectiveness

3.2.3.4. Repayment plans and scheduling

3.2.3.5. Accountability enhancement
3.2.3.6. Efficiency plans for business enhancement

3.2.3.7. Other

3.3. Application of the forum concept

Once the Charter agrees on the forum concept, it directs the formation of the forums and their formulation with some important operating guidelines. Typically a forum will be established depending on the requirements of the specific venture. Whenever outside acumen is required for a specialised industry, it is “contracted” externally.

The broad process for the forums is shown in the diagram;

3.4. Chapter summary

This chapter described the requirement for a Charter and proposed the forum concept to address the binding constraints as reported in Sub-section 2.4.1.

The proposed Charter defines the cooperation and collaboration between stakeholders to govern the operation of the forums which are the vehicles to address the paradoxes. Within this framework, SMME&Cs can function optimally.
While the aim is to govern intervention directed at mainly turnaround and business rescue as strategies, it automatically provides for retention decisions too.

The forum concept is described showing how it can be constructed, how it operates and the process of its actions. Key to the process is that it should meet regularly and consistently with pre-emptive focus.
Small Business Distress and Recovery Principles

Chapter 4

Assess distress and verification
4. ASSESSMENT OF DISTRESS AND VERIFICATION OF REASONABLE PROSPECT

Chapter 3 has mostly stated and elaborated the requirement for a Charter and the forum concept as pre-requisites for meaningful progress in the SMME&C. This chapter proposes an overall process and strategies to be incorporated in the forum concepts for different ventures.

The underlying pre-requisite of the forum operation requires that a standardised assessment process is to be established. Assessment must be done regularly to trigger action by the relevant forum. During interviews, participants indicated that there should be room for different methods of assessments as it provides for the acumen especially associated with external advisors.

Assessment is pivotal in triggering the overall process of turnaround or business rescue and even when evaluating for growth and retention.

4.1. The overall process model to inform a forum process

Figure 4.1 proposes an overall process to guide forum operations in addressing distress and guiding rescue, turnaround and retention strategies. Each part is expanded in the sections that follow. The numbers in the diagram indicate the relevant chapters associated with each part. Each of the steps are further expanded in the following chapters.

From the diagram, the observer can follow the process from the onset of distress, executing a three step quick reasonable prospect assessment and then towards the intervention through a strategy plan. These key steps take place within the governance of the Charter and operations of the forum.
4.2. Reasonable Prospect Analysis (RPA)

Once a venture has entered the Zone of Insolvency and experiences distress, the process is triggered.

4.2.1. QRPA – what is it?

What is proposed in this section is one potential process namely a quick reasonable prospect assessment (QRPA). The process involves techniques that do not necessarily depend on financial data as pre-requisite. The reasons for this is information asymmetry and the liability of data integrity that is characteristic of SMME&Cs. We therefore lean towards subjective measures as they provide support for decision making when generally there is a shortage of accurate information. Any financial data will improve decision making.

The QRPA consist of three integrated components namely the turnaround situation (TAS), the severity analysis and the opportunity-resource diagnostic. Each is explored separately.

Several methodologies of assessment are available in the literature. Advantages and disadvantages between methods vary and are supported differently by different observers. Banks for example have their own assessments methods while “vulture capital providers” of PCF have others, depending on the business models and strategies. What is therefore proposed in this section relates to methods used by the authors in their academic positions as well as consulting interventions.

One of the Charter functions should therefore be that of establishing what the more useful methods to be selected are.

We propose RPA as a base in this report.

The process starts with cognition\(^5\) that the venture has entered the zone of insolvency. Thereafter it pursues the QRPA process steps.

### 4.2.1.1. Turnaround situation (TAS) judgement

The TAS\(^6\) judgement is the first evaluation of the specific venture situation. It assists in determination of the unique configurations and distress causality which specifically addresses strategic versus operational causality.

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Within each quadrant of the TAS analysis are some indicators to guide the decision makers about the relevant status.

By determining the specific situation whether performing well (can be associated with distress), under performance, strategic distress or crisis, it informs the forum about the origin of distress.

The appointed forum members could establish a reasonable sense of the specific situation without financial data. The next step is to establish the severity of the distress.

4.2.1.2. Severity evaluation (SE)

The severity evaluation (SE)\(^7\) investigates patterns and status of the venture at the point in time when cognition takes place. It considers specifically cash flow for the past 3 terms (preferably monthly but quarterly could also work), gearing, slack and industry position.

Severity is typical described by looking at gearing, cash flow over three periods before the QRPA, Slack of resources, A Z-score if available and finally the typical position of the venture in the industry (such as leader, also run, insignificant). It is important to recognise that more or other

\(^7\) Management Transfer cc - Unpublished material
variables are or could be relevant and used. The diagram shows the 3 main areas by green, orange and red colours (traffic light principle) to guide the evaluation. It is possible that a business venture may be judged to show signs of two or more blocks simultaneously.

4.2.1.3. Opportunity-resource diagnostic (ORD)

Once the TAS and SE have informed the decision makers (forum), the ORD requires a somewhat forward looking judgment. ORD asks the question if there is balance between the opportunity (perceived) and the resources available. The nine blocks propose which element is absent or insufficient. It is possible that both are negative and often this points to a fatal flaw in the value model that is proposed.

Case examples of fatal caveats

Case 1: A local business was exporting 100% of their product namely medical kits for cars to France as any car on the road was legally bound to have such a kit on board. Along came a change in the law that eliminated this legal requirement. Suddenly the demand disappeared (strategic distress) rendering the business value model insignificant to pursue.

Case 2: Several local SMME participated in the provision of pre-paid meters to a City Council contract. Their sole demand depended on the contract that was disputed and found illegal – therefore all these businesses lost the key factor of demand.
4.3. RPA Outcome

Combining the 3 elements of the QRPA informs the overall outcome. It correlates with “feasibility” judgement.

RPA outcome is typically categorical in nature. The 4 broad categories of relevance include (see also the next diagram):

RP exists with proper management (Score =3)

RP but require resource infusion (Score = 2)

RP with addressable caveats (Score = 1)

No RP as a result of fatal caveat (Score = 0)

DETAILS OF THESE LEVELS ARE EXPANDED IN CHAPTER 6.

It is important to realise that the QRPA is a value judgement based on incomplete information and therefore subject to verification. The positions indicated in the diagram are approximate positions.

For this study we did not include start-up failure as a result of foundation difficulties\(^8\) (See Figure 4.2).

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\(^8\) Provasi, R. 2016. The ability of the turnaround index to assess going concern assumptions: evidence from its application to Italian listed companies. Global Business & Economics Review 18 (1).
Each score requires alternative responses as will be explored in the next chapters. Strategy responses to each level is expanded in Chapter 6.

4.4. Verification of the outcome

Most cases of RPA determination is associated with the liability of data integrity\(^9\). Thus once it is established, the forum can call for verification through a due-diligence process to confirm accuracy and trustworthiness of the data. It often happens that RPA outcome is accepted subject to specific verifications of for example a contract, a price, a costing, an ownership confirmation etc.

Verification is a deeper investigation, more time consuming, considers risk and often has a financial underlay. Verification also addresses information asymmetry.

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4.4.1. Other models that can be considered

- Opportunity analysis\textsuperscript{10}
- Likelihood of Liquidation model LOL\textsuperscript{11}
- Due diligence
- Going concern evaluations
- Other

4.5. Chapter summary

This chapter expanded the RPA Interviews with relevant stakeholders to gather information for Report 2 has already started.

The chapter describes the assessment of the distressed ventures through a quick reasonable prospect determination the guide forums in selecting the relevant initiatives in response.

The QRPA considers the turnaround situation, severity and resource –opportunity diagnostic in a three step process to inform the forum of the initial judgement.

The outcome of the QRPA is described shortly but expanded in Chapter 6.


Small Business Distress and Recovery Principles

Chapter 5

Intervention strategy plan

Process and structure of Report

- Introduction and research method (Chapter 1)
- Industry Status quo description (Chapter 2)
- Establish Charter (Chapter 3)
- Forum Governance (Chapter 3)
- Assess Distress and verification (Chapter 4)
- Intervention strategy plan (Chapter 5)
- Initiatives to consider (Chapter 6)
- Summary and conclusions (Chapter 7)
5. INTERVENTION STRATEGY PLAN

Chapter 4 has expanded on the RPA through explaining the QRPA from entering the ZoI until the final RPA outcome. Once a forum has established the outcome level and verification has been done (or not), the forum is now in position to develop the intervention strategy. These could include retention, turnaround or business rescue with their specific associated practices. In addition, strategies for growth, expansion, diversification, entering alternative markets etc. This chapter now expands the specific broad strategies associated with each as well as stipulate their associated practices.

Within the brief of this report, the three sets of strategies are for business rescue, turnaround and retention mainly although some reference to other were indicated.

Strategy decision making is a response from management to the specific contextual conditions (external and internal environments) while considering vision, mission and resources to pursue identified opportunities.

The potential strategies and their associated practices are unlimited and depend on the sense-making of the RP outcome. However, researchers have identified two main stages in the turnaround process, retrenchment and recovery. The first is when the cause of organisational distress is found and the TP with managers are inspired to act, they are likely to retrench or cut back to a manageable core of operations to stem the decline. This will in effect afford the business the necessary time to deploy recovery efforts while the business resumes what it knows best. Second, a recovery phase is entered where a business will take the appropriate and specific actions that return them to previous positions of security.

5.1. Strategy initiatives formalised in a plan

This chapter is about a formal plan that should be compiled under the oversight of the forum. Normal businesses have business plans, expansion plans and growth plans. Distressed businesses may have turnaround plans or rescue plans. These plans are addressing similar issues most of the time.
The extent of such plans varies from formal to informal. Most entrepreneurs only rely on vague plans (sometimes only in their heads).

Forums should assist SMME&C managements to develop these plans based on the RPA Outcomes.

5.1.1. Plan components

All plans have minimum requirements. Chapter 6, Section 150, is prescriptive for what a rescue plan should incorporate. However, this may vary depending on the specific context of the venture under consideration. Turnaround plans may vary but address similar concerns. What follows is a broad structure of the minimum requirements for inclusion in the turnaround plan. Section headings are postulated.

Most funding organisations have comprehensive requirements for inclusion in business plans.

| Many business plan formats do exist in both literature and practice. Therefore, only the headings to be considered by the forums is stated in this report. |
| Within the economic cluster, the ACO is used by SEDA, SEFA, DTI and Productivity SA. It serves a similar purpose. |
| Turnaround and rescue plans have some elements that are additional to the standard business plan. |

5.1.2. Intervention strategy plan components – minimum requirements for SMMEs to include:

- **Short background to the venture**

- **Clear description of the distress causality**

  The causes of distress are carelessly described in turnaround literature as common, immediately identifiable internal and external issues such as shortage of cash, poor financial control, poor management, and the collapse
of key markets. However, it is important to distinguish between these causes, which are in fact secondary causes, and a deeper, more fundamental despair that relates to organisational learning. These issues are known as the primary causes of decline. The latter are often not clearly understood and received little attention in theory or practice.

- Origin of the distress – strategic vs operational
- Value model pursued
- Demand for value model
  - Past demand
  - Projected demand
- Financial status based on last three months
- Broad strategy alternatives
- Specific initiatives (See Chapter 6)
- Funding requirements
- Projections
  - Income projections
  - Cash flow projections
- Time lines
- Score card
- Specifics that are unique to the venture
- Plan summary

5.2. Stakeholder support
Figure 4.1 indicates that if the stakeholders support the forum’s proposed intervention strategy plan Interviews with relevant stakeholders to gather information for Report 2 has already started. The interview protocol guideline is attached as Annexure A.

Some respondents appeared hesitant to contribute alternatives that can be pursued. This rather confirms that business rescue and turnaround are not widely and formally pursued within government stakeholder structures. It acknowledges that it requires high level acumen.

5.3. Summary

A business rescue or turnaround plan is specific to the venture it is compiled for. What is presented in this charter are generic headings that a forum should consider for inclusion or not.

Various plans have different levels of complexity that depend on the specific contexts for each venture.
Small Business Distress and Recovery Principles

Chapter 6

Initiatives to consider in the plan

Process and structure of Report
6. INITIATIVES TO CONSIDER IN THE STRATEGY

Chapter 5 has focused on and elaborated the strategy initiatives and components of the turnaround plan. These initiatives inform the strategy plan whether it is a rescue plan, turnaround plan, retention plan of whatever kind.

This chapter focuses on the initiatives to consider when selecting the strategy to pursue. Each element requires investigation to find complete clarity and consideration by the forum. This allows for the expansion of the forum to include specialists.

The headings (See also Figure 4.1) are the key elements that are used in “Do We have a Business – test (DWaB-test) also known as the key elements to consider when comparing an idea vs an opportunity for business.

6.1. Sense making of the RPA levels

Sub-section 4.3 reported the levels of RPA Outcome. Each level requires the forum to understand and GRASP the context in which distress must be addressed.

6.1.1. Level 3 RPA Outcome – Where RP exist with proper management

For a venture with an RPA Outcome of 3, it suggests that all the “makings” of a business still exists and following a relevant strategy, the business can be saved, turned around or rescued based on a proposed plan. SE is typically low (see Sub-section 4.2.1.3). Despite the distress, the strategy and its implementation would probably be successful. This is typically associated with ventures that suffered poor management decisions, did their business poorly (inefficient) but the problems which are mainly operational in nature, can be addressed. BRPs and TPs flourish on such ventures as they are seen as fairly easy to save.

6.1.2. Level 2 RPA Outcome – Where RP exist depending on resource infusion

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For a venture with RPA Outcome of 2, it suggests that most of the “makings” for a business exist pending the infusion of additional resources (typically refinancing) as part of the relevant strategy. The severity evaluation (SE in Sub-section 4.2.1.2) is medium overall. Such ventures can be saved, turned around or rescued based on a proposed plan containing a willing participant to provide resources. Despite the distress, the strategy and its implementation could probably be successful. Most distressed ventures claim to only require external finance (debatable). This is typically associated with ventures that require alternative assets / technology to address inefficiency problems. BRPs and TPs with specific business industry acumen can save such ventures as they are seen as fairly easy to solve.

Previous research has shown that formal business rescue under Chapter 6 in South Africa, the success rate was 9.4%. Success incorporated restructuring to solvency as well as BRiL.

6.1.3. Level 1 RPA Outcome – Where RP exist only after fixing an addressable caveat

For a venture with RPA Outcome of 1, it suggests that the “makings” for a business are depleted and the SE shows low levels. A relevant strategy may be formulated pending both resource infusion and addressing external limitation such as new markets, alternative production, outsourcing etc. The venture can be turned around or rescued based on a proposed plan but is risky. Despite the distress, the strategy and its implementation could probably be successful depending on the nature / causality from any caveats. This is typically associated with venture that suffered both poor management cognition of environmental threats and [no or incorrect] responses. It suffers both strategic and operational threats. While problems can be addressed, it is high risk. BRPs and TPs require expert acumen for such ventures as they are seen as high risk to solve.

6.1.4. Level 0 RPA Outcome – Where no RP exist a.r.o fatal caveat/s
For a venture with RPA Outcome of 0, it suggests that the venture faces a caveat that is fatal in nature. Such a caveat can be loss of a major contract on which the venture was established or innovative substitutes in the market etc. The venture may have some of the “makings” but a crucial one is absent and cannot be addressed. No strategy can work and either a BRiL or liquidation route is relevant. Occasionally it is possible to be acquired by another venture but this forms part of BRiL alternative anyway.

6.2. Decision making

The RPA Outcome is a determination that govern the next steps. It represents a crucial decision making point within the overall process. The decision context contains distress within the ZoI which is characterised by uncertainty, complexity and ambiguity. The forum allows for wider insights in often volatile circumstances.

6.3. Categories of strategy interventions

In this section, a list of 7 categories are identified for attention by the forums. This list is not exhaustive but contains the key considerations that can govern the turnaround or rescue strategy choices (See also Figure 4.1).

From the categories, note that each category name contains a verb/adverb describing the action to be considered.

Figure 4.1 also shows an arrow pointing backwards from the initiatives towards the Intervention strategy plan suggesting that it informs the plan that must address the specific RPA Outcome. Thus, the initiative categories can also inform the RPA when it is converted into questions when doing the assessment.

6.3.1. Demand fixing

Demand for the venture’s concept (value proposition) is the main driver of a business. No customers means no sales means no business.

At this point it is necessary to evaluate the past (preferably 6 months) and project the future (min six months preferably 24 months)
Demand requires pursuing markets through any one or more of the following practices:

- Penetration of existing markets
- Market expansion
- Pursue alternative markets
- Alternatives access (Channels) methods
- Other

It is obvious SMME&Cs are limited in the use of all the alternatives. Specific practices must therefore be identified by the forum. This is also relevant to the strategy initiatives that follow.

6.3.2. Operations and appropriation fixing

Fixing operational capacity to appropriate the value concept (products or services) can take many forms depending on the venture itself. Such practices may include alternative operations, improved productions, changing supply access and more.

6.3.3. Value model alteration or improvement

Value models for SMME&Cs are often limited to very basic provision of products. The smaller the venture, the more this is so. A value model is at heart what the business is about.

Value models suffer mostly from changes in the external environment especially a.r.o. technology and globalisation that changes across borders. This brings about substitute products for the customer to choose from.

The forum should challenge the existing model (done in QRPA) and advice the strategy.

6.3.4. Liquidity and finance fixing
Most turnarounds and business rescues require some form of financial restructuring. This is either to support alternative appropriation capacity, fund alternative product lines, expand with alternative supply chains etc. Alternatively it is to fix cash flows by means of payment plans and cash cycle improvement.

6.3.5. Caveat addressing

If there are caveats, the forum must decide how to address them. Often, if some caveats cannot be overcome, they are fatal to the survival of the venture in its current state.

6.3.6. Error and risk overcoming

Addressing risk goes hand in hand with caveat addressing. Small firms are typically more prone to demand, price, location changes such as a large competitor entering the area through for example a giant superstore or supplier opening in close proximity.

6.3.7. Acumen transfer

Often, SMME&Cs lack acumen access. A forum could be the first step in overcoming such shortcoming. This is even more so for turnaround and rescue acumen. The competencies

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required by such individuals have been described to include sense-making, decision making, collaboration and integration that culminates in the supra competency of navigation towards a “better position”. See also the associated diagram.

It is clear that acumen requirements are highly specialised and can hardly be obtained through basic explicit knowledge transfer.

Research has also shown that little knowledge\(^\text{13}\) has been transferred from BRPs to entrepreneurs and directors of distressed businesses that came out of business rescue [or not]. This confirms the importance to understand the difficulty by which acumen transfer takes place.

It is purported in this research that acumen transfer should be prioritised for all interventions by the sector overall. Cooperation with the TMA is advisable in this regard.

6.3.8. Other

Depending on the specific context of each distressed venture, there may be additional factors to pay attention to.

6.4. Generic strategies to inform decision options

What follows in this section are practices that are associated with generic strategies available to a distressed (and going concern) ventures to pursue within the specific RPA Outcome.

6.4.1. Generic strategies based on a TAS

Already described in the literature are strategies to respond\textsuperscript{14} to the various TASs that is part of the response to the RPA. Each strategy is supported by practices that may contribute to achieving the relevant generic strategy. The diagram proposes some practices for the four sets of turnaround strategies. Forums must deliberate the relevance of each as it is linked to the RPA. See also Sub-section 4.2.2.1 to recognise the links between the symptoms/indicators related to this diagram of practices.

\textbf{The diagram shows practices, initiatives and actions that can be used to respond to the outcomes of an RPA. Forums could consider each for relevance to the specific distress context. It is hardly possible to be prescriptive on the selection. Selection of practices are often determined by the competency levels of the practitioners involved and thus governed by acumen.}

The four strategies depend on the specific TAS and are:

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  \textbf{Sustainability strategy} that addresses retention of the performance in response to a performing well TAS.

• Efficiency strategy that addresses turnaround for an under-performing TAS

• Forced repositioning strategy when a venture is faced by a strategic distress TAS.

• Last resort strategy for ventures where distress is categorised as crises TAS and rescue is consider. Often times, liquidations should be alternative.

6.5. Summary

Chapter 6 pointed towards key initiatives to inform the intervention strategy plan (Chapter 5) which is compiled in response to the RPA Outcome (Chapter 4).

This chapter proposed a list for the forum to enhance their decision making.

A wide variety of practices do exist within each TAS. The elements presented should be considered by the forums for relevance for the venture under consideration.
Small Business Distress and Recovery Principles

Chapter 7

Summary and conclusions and recommendations

Process and structure of Report

- Introduction and research method (Chapter 1)
- Industry Status quo description (Chapter 2)
- Establish Charter (Chapter 3)
- Forum Governance (Chapter 3)
- Assess Distress and verification (Chapter 4)
- Intervention strategy plan (Chapter 5)
- Initiatives to consider (Chapter 6)
- Summary and conclusions (Chapter 7)
7. SUMMARY AND THE WAY FORWARD

Chapter 6 has mostly stated and elaborated the concepts from the different literatures and researches executed. This chapter however expands to some extent on the basics of turnaround situations, generic principles and strategies in turnaround.

Summary of recomendations of this report:

7.1. Business Rescue

7.1.1. Monitoring of “approved” BRPs (BRP rating)

It is recommended that government departments organisations that are authorised to appoint or ratify the appointment of BRP’s do so in accordance with the strictest requirements. Similarly, to the banking fraternity, government bodies should develop an “approved” list of BRPs. BRP’s should be rated accordioning to their success rate and compliance with the procedure. Furthermore, approved BRP’s should be part of a professional body.

7.1.1.1. Legislative amendments

We recommend that the following two areas of legislation be reviewed.

7.1.1.1.1. BR for SMMEs

A modern SMMEs restructuring and insolvency framework should address the specific challenges of these types of businesses on both the micro- and macroeconomic level.

SMME’s retain limited resources therefore causing a financing problem in insolvency that should not be solved by denying such businesses access to proceedings. In most cases, business rescue will not be a viable option for SMMEs if the company does not have sufficient resources to cover at least the expenses of the BRP. Denying orderly collective proceedings for the SMME sector may result in viable high growth firms from foreclosing. We therefore suggest that special rules be created for BR to assit exclusives SMME’s.

7.1.1.1.2. Insolvency Act – “fresh start”
South Africa currently has an old insolvency system that is not conducive to growth or SMMEs. An insolvency system covering SMMEs should acknowledge the characteristics of this sector and aim to maximize assets and preserve the company on one hand and provide for discharge and a fresh start for the entrepreneurs involved on the other. The goal would be to distinguish the effects of insolvency on the enterprise from those on the individuals behind the enterprise. Continuity is possible for an incorporated entity, but more difficult for an individual operating without the protection of incorporation.

7.2. Turnaround

7.2.1. Establish charter for distressed businesses

The report proposed the Charter as the main prerequisite to address/overcome the reported fragmentation effect hampering collaboration. The Charter is the governing structure of the proposed forum process. Without a Charter structure, conditions for cooperation are limited.

7.2.1.1. Use existing resources (Productivity SA; Mentors ect..)

It should be emphasised here that the recommendations made under the charter and forum do not require additional resources to be allocated. This study has identified adequate resource (excluding acumen) availability to implement both the charter principles and forum concept. The charter should be designed to better utilise the resources already being allocated to distressed business across the economic cluster.

7.2.1.2. Forum structure

The forum concept addresses improved decision making by addressing stakeholder support, access to acumen, improved governance and management. Forums allow for flexibility and responding to the specific distress situations while it can be seen as the first step in acumen development.

7.2.1.3. Generic assessment for unique venture
Assessment by the forums are proposed to be somewhat standardised in order to optimise the limited resources for turnaround and business rescue within the economic cluster structure. The proposed methodology of the QRPA is merely a starting point and could be enhanced. It however appears adequate for the SMME&C industry. Assessment should be regular (proposed as quarterly at least).

7.2.2. **Unique response to RPA**

Every venture is subject to its own contextual factors and therefore distress may take many forms. While generic factors may exist, they manifest differently in individual ventures. Therefore, the QRPA is a framework that could guide decision making. A standardised yet flexible analysis tool will be hugely beneficial to any turnaround efforts.

7.2.3. **Distressed grant requirements**

As the state considers availing distressed funding to SMMEs, it is recommended that this is done with caution. The state should avoid advancing any grant or non-interest-bearing loan to distressed companies. One of the key indicators of viability is the firm’s ability to successfully emerge from turnaround without subsidisation. If grant funding is awarded, this may disguise deepening insolvency and keep non-viable firms operating. Distressed financing (ex: as provided by IDC) is expensive and should only be reserved to firms that show a reasonable prospect of successful turnaround.

IDC requirements are shown on their website\(^\text{15}\)

7.2.4. **Turnaround advisor’s qualifications**

While BRP’s must adhere to strict qualification and expertise requirements this is often not the case with turnaround advisors. This is very concerning. It is highly recommended that ordinary mentors or business consultants are not automatically regarded at turnaround advisors. The field of turnaround management is highly specialised and consultants in this field must show distinctive competences in order

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to be effective. Close cooperation with the TMA should be sought as it is an accredited body.

7.3. Retention

7.3.1. **Aftercare support & budgeting**

It is recommended that a proportion of the funds allocated to SMMEs be reserved for aftercare support. Statistical analysis of the SMME sector shows a high failure rate. While this is not abnormal, if turnaround services are to be made available then it should be proportionately budgeted. Any SMME funding or grants should be made in view of possible future turnaround support.

7.3.2. **Regular monitoring as prerequisite**

There is a need for early cognition of distress which is mostly absent in SMME&Cs and therefore the Distress Charter guideline of regular monitoring as a prerequisite for the forum functioning. This enforced trigger point is most useful for activating and improving basic management in SMME&Cs – therefore avoiding distress.

7.3.3. **Shift measurement from start-up numbers to sustainability (“single customer dependency”)**

In order to reduce the number of SMME failures and increase the retention rate a mindset shift is necessary. Currently, SMME growth is primarily measured on the quantity of SMME’s and jobs created. We highly recommended that the new focus should look at SMME sustainability. The effectiveness of state support to SMME’s should measure how sustainable these firms are rather than only how many exist or number of jobs they create. ‘Single customer dependency businesses’ should be flagged as high risk. If this mind shift does not take place, our efforts within the SMME sector will have little effect on the much needed job creation over the long term.
7.3.4. **Acumen creation**

Turnaround and business rescue acumen is the resource that is extremely scarce, not only for SMMEs but generally. It has been clearly described by the acumen paradox. The forum is the first step in addressing this shortcoming. The research showed clearly that currently, the turnaround and business rescue acumen of advisors in the sector is low and problematic to some role-players. It is proposed that expert panels should be built to assist forums when required in order to start the acumen transfer process.

7.3.5. **Distress Charter as prerequisite to address collaboration**

The report proposed the Charter as the main prerequisite to address/overcome the reported fragmentation effect hampering collaboration, coordination, alignment and information sharing. The Charter is the governing structure of the proposed forum process. Without a Charter structure, conditions for cooperation are limited.

7.3.6. **Forum as concept (vehicle)**

The forum concept addresses improved decision making by addressing stakeholder support, access to acumen, improved governance and management. Forums allow for flexibility and responding to the specific distress situations while it can be seen as the first step in acumen development. The forum typically has the decision making functions associated with a board of directors.

7.3.7. **Regular monitoring as prerequisite**

There is a need for early cognition of distress which is mostly absent in SMME&Cs and therefore the Charter guideline of regular monitoring as a prerequisite for the forum functioning. This enforced trigger point is most useful for activating and improving basic management decision making in SMME&Cs.

7.3.8. **Generic assessment for unique venture**

Assessment by the forums are proposed to be somewhat standardised in order to optimise the limited resources for turnaround and business rescue within the
economic cluster structure. The proposed methodology of the QRPA is merely a starting point and could be enhanced. It however appears adequate for the SMME&C industry.

Assessment should be regular (proposed as quarterly at least).

7.3.9. Unique response to RPA

Every venture is subject to its own contextual factors and therefore distress may take many forms. While generic factors may exist, they manifest differently in individual ventures. Therefore, the QRPA is a framework that could guide decision making.

7.3.10. Acumen creation

Turnaround and business rescue acumen is the resource that is extremely scarce, not only for SMMEs but generally. It has been clearly described by the acumen paradox. The forum is the first step in addressing this shortcoming.

The research showed clearly that currently, the turnaround and business rescue acumen of advisors in the sector is low and problematic to some role-players.

It is proposed that expert panels should be built to assist forums when required in order to start the acumen transfer process. A distinction is required between business advisor acumen and turnaround/BR acumen. This research indicated that BA acumen is low which leads to poor aftercare when investments are made leading to low retention and sustainability. On the other hand, TA/BR acumen is almost not existing and will require large amount of resource inputs to address it meaningfully.

7.4. Specific recommendations for considerations

What follows in this section are recommendations (after feedback meetings) for the specific interventions associated with the Charter and Forums:

7.4.1. Charter interventions and considerations

The report proposed the Distress Charter as the main prerequisite to ensure cooperation, coordination and collective responsibility.
7.5. The way forward

It is proposed that the economic sector considers the report especially for agreement on the Charter principle followed by the forum concept. Thereafter guidelines need to be established and agreed upon for operations of the forums.

The proposed action program contains 9 activities with timelines to be pursued. It is important that these are proposed by the research team therefore representing their insights from the research process.

Also submitted are proposed additional initiatives to be considered by the DC for urgent attention.

Extensive training of advisors will be beneficial to begin addressing the rescue and turnaround acumen shortage.

Agreement on the proposed QRPA methodology (or other) should begin as part of the forum guidelines. Annexure B is shown as an example of a RPA outcome purely serve as a case example of how decision making by the forum could be influenced by its use.

A one day intervention for advisors to introduce the complexities of the Act and proposed processes from the report will be done at the DSBD arrangements and venue as soon as the report has been accepted. However, an extensive program is required.

The proposed project program is presented as as a recommendation:

Proposed action program for DSBD
7.6. Chapter Summary

In line with the brief of this research, a framework was presented (Figure 4.1) that proposed a process with steps for the sector to consider. This may guide addressing the constraints currently faced by the sector.
Specifically, this report presents the QRPA to establish assessment on a regular basis for SMME&Cs supported by government structures.
ANNEXURE A.

See Report 1 of 2
ANNEXURE B – Integrated case study: RPA outcome example

Case study example of recent anonymised SMME where RPA was applied (R20 million annual T/O).

Business name: XYZ Tech – Furniture manufacturing

RPA framework score = **21.7**

Interpretation: Operational distress moving towards **Strategic distress**

**Severity Evaluation:** is urgent in response to entering crisis

Table 1 Application of the reasonable prospect assessment (RPA) score for different turnaround situations when operating in the ZoI (Pretorius, 2017 in press)

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<thead>
<tr>
<th>Business Categorization</th>
<th>Affordance scores allocated</th>
<th>Max Score</th>
<th>Log score</th>
<th>RPA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Distressed Business</td>
<td>D</td>
<td>AC</td>
<td>PM</td>
<td>LF</td>
</tr>
<tr>
<td></td>
<td>1.5</td>
<td>1.75</td>
<td>2.75</td>
<td>1.75</td>
</tr>
</tbody>
</table>

Scoring: Judgments from observers

*Clear path to best-envisioned endpoint (4) = confirmed future existence, sustainable

Healthy status with potential path (3) = Currently exist, assumed future existence under proper management

Questionable and unclear path (2) = Currently danger levels, doubtful, improbable, (Quantify in RE)

Absent (1) = Non-existing path or beyond fixing

Risk and Error - Doubt/Uncertainty about accuracy of factual information at the decision point in time

**Fatal caveat: Exist=0, None=1**

RPA Score

\[
\text{RP} = \int (aD + bAC + cPM + dLF) \times eFC \times fRC \times g(1-RE)
\]

Where

\( \int = \text{function of; } D = \text{Demand for selling the concepts; } AC = \text{Appropriation capacity for the concept; } PM = \text{Profit model; } LF = \text{Liquidity and financing model; } FC = \text{Fatal caveats; } RC = \text{Rectifiable caveats influencing performance; } RE = \text{Risk and error; } a - g = \text{constants determining level of judgement.} \)
Figure 1
Reasonable prospect assessment with RPA scores to guide assessment

1 Demand appears to exist
2 Appropriation capacity exists
3 Management strive creates suspicion and needs in-depth investigation
4 BM profitability suspect – needs investigation

Cross check - Opportunity for distressed business

Opportunity Score = $78 + (2 \times RC \text{ and } 0 \times FC)$

**Interpretation:**

**Explanation of the scores**

- Above 131: Excellent turnaround opportunity
- 101 to 130: Good turnaround opportunity to pursue
- 81 to 100: Turnaround opportunity need some work – there are some critical issues to overcome
- Below 80: Dangerous turnaround opportunity – potentially there are some key flaws

**Beware of any scores equal to one** – investigate those before proceeding even when the score is above 100

From Sub-section 6.3 it is now possible for the forum to direct their decision making
Arriving at the unique individual strategy for a SMME&C

1. **ORD**: ORP = + + +
   - Zol = 80%
   - DSR = 1.25
   - P = +

2. **Severity**: S = 80 - 90
   - DSR + Good
   - Zol = 1.25 in 1.50
   - P = +

3. **3 Charter & Forum**
   - Governance Accountability Scorecard
   - 5 Intervention strategy plan

4. **Verify**

5. **6b Generic TA Strategies**

6a **Strategy initiative categories**
1. Demand fixing
2. Ops and appropriation fix
3. Value model creation
4. Liquidity & model
5. Caveat addressing
6. Error and risk overcoming
7. Knowledge Transfer

**QRPA**

**Zol**

**TAS**

**Stakeholder support**

**Stakeholder resource infusion**

**QRPA Outcome**