



A qualitative exploration of the bidding processes used in business rescue



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Orientation: In business rescue, when pursuing the sale of the business to a third party, the business rescue practitioner (BRP) may use different bidding processes to interact with and select buyers.

Research purpose: This study aimed to provide a framework to classify and describe the various bidding processes, including identifying the factors that would preserve value to the benefit of creditors and shareholders.

Motivation for the study: Chapter 6 of the *Companies Act* is silent on the requirements regarding bidding processes. Therefore, the industry and legislator may benefit from guidance from industry experts.

Research approach/design and method: Qualitative exploratory, using semi-structured interviews with 11 South African senior business rescue practitioners.

Main findings: Three types of bidding processes were identified. In a sophisticated bidding process, information is communicated to buyers using a virtual data room. The second bidding process is less sophisticated; printed document packs are provided to bidders, and bids are submitted in tender boxes. Thirdly, the private bid-out process, where preferred bidders compete against each other in a closed envelope boardroom auction. The findings also revealed that deal certainty is more important in business rescue than ordinary mergers and acquisitions. Moreover, an equitable value, rather than a general market value, is often applied because of the bidding process. Lastly, the study identified a need for the pre-involvement of the BRP before a company files for business rescue, an aspect not currently allowed by the *Companies Act*.

Practical/managerial implications: BRPs can benefit from the explication of the types and detailed steps of bidding processes. Moreover, the findings fill the void of limited guidance in the *Companies Act*.

Contribution/value-add: The classification and description of the various bidding processes and key considerations in the context of a business rescue will assist BRPs in South Africa in preserving value under business rescue and guide the legislator in amending the *Companies Act*.

Keywords: acquisitions; bankruptcy sales; bidding; business rescue; distressed investing; mergers; restructuring; tender.

Introduction

The *South African Companies Act*, Act 71 of 2008 allows a business rescue practitioner (BRP) to either restructure the affairs so that the company can exit business rescue in a solvent state or use the time under business rescue to pursue a better return to creditors and shareholders than immediate liquidation (RSA: s 128[1] [b] [iii]). The latter is also known as BRIL (better return than under immediate liquidation). When pursuing the BRIL alternative, South African companies in business rescue are often sold by BRPs. This alternative outcome is popular as it preserves job opportunities (Conradie & Lamprecht 2018). By preserving employment, the South African government is supported in achieving the macro-economic and social goals for South Africa (Pretorius & Du Preez 2013).

Research orientation

When a third party buys a business in business rescue, it can be considered a specific type of merger or acquisition. Because of the negative impact of COVID-19 on the South African economy, an increase in distressed mergers and acquisitions is expected. The recent examples of

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listed companies EDCON (Businessstech 2020) and Group 5 (Creamer Media 2021) are striking examples. However, little is known about African mergers and acquisitions (Angwin et al. 2016) and, specifically, those in South Africa (Opoku-Mensah et al. 2019). In Europe, executing business rescue through a going concern sale requires (1) a bidding process, (2) a tool to leave debt behind (asset deal free and clear or share deal in a restructuring plan) and (3) a tool to test the agreed price, such as court scrutiny of the bidding process or creditor approval (Wessels & Madaus 2018).

Although the terminology might differ from country to country, the terms 'auction' and 'bidding process' are used interchangeably. Both describe a sales process. Auctions or bidding processes can take on many forms, with the ascending auction (also called the open, oral or English auction) and the sealed-bid auction being two of the popular ones (Perry, Wolfstetter & Zamir 2000). In the ascending (English) auction, the price is successively raised until only one bidder remains, who then wins the item at the final price. In this type of auction, the seller can announce the prices, bidders call out prices themselves or bids are submitted electronically with the best current bid posted. In a sealed bid auction, all bidders submit their bids to the auctioneer. After the opening phase, the auctioneer publicises all the bids and determines the winner (Klemperer 1999). Sealed-bid auctions are a good practical choice because they require little communication or interaction between the participants (Yang, Naseri & Wen 2009).

Typically, in South Africa, where auctions happen under liquidation circumstances, it is sold to the highest bidder at 'the fall of the hammer' (The High St Auction Co. 2022). Buyers pay a refundable deposit before the auction to the auctioneer. This deposit will be refunded if the buyer is unsuccessful in buying the item auctioned (The High St Auction Co. 2022). The cost of such an auction can be extremely high. Auctioneers, of which The High St Auction Co. is considered 'one of the best' in South Africa, ask a premium of 10% plus value-added tax (VAT) on the bid price (The High St Auction Co. 2022). In addition, the liquidator is paid 10% of the value of movable assets, 3% of the value of immovable assets, as well as a prescribed liquidator's fee (Tayob 2016:26). In contrast, a BRP is reimbursed on an hourly basis for their services (Tayob 2016:26).

Some of the procedures used in a liquidation auction might possibly be used in obtaining a BRIL under business rescue. However, using the auction or bidding procedure under business rescue can provide qualitative benefits; besides saving costs, business rescue also tends to preserve the value of assets better (better maintained until sold) (Tayob 2016:26). There are also no time constraints in paying out proceeds in business rescue, whereas in liquidation, proceeds can only be paid out once the Master of the High Court approves the liquidation and distribution account. This process can take 22–36 months or longer in liquidation (SARIPA 2018; Tayob 2016:26). In liquidation, assets are usually sold piecemeal, as staff have already left the business, while under the BRIL in

business rescue, the BRP attempts to sell the business as a functioning unit (Tayob 2016:26).

Previous research in South Africa confirmed the use of bidding processes when selling companies in business rescue (Britz 2018; Conradie & Lamprecht 2021). However, in the context of a South African business rescue attempt, where the BRP pursues a BRIL, these studies failed to describe the various bidding processes and important considerations during the BRPs decision-making that could preserve value for creditors and shareholders.

Research purpose, objective and questions

The purpose of the article is to, in the context of the BRIL alternative, provide a framework to classify and describe the various bidding processes, including an identification of the factors that would preserve value for creditors and shareholders. To achieve the purpose of this article, two research objectives are formulated, namely: (1) to provide a framework to classify and describe the various bidding processes and (2) to understand the factors that would preserve value for creditors and shareholders.

The authors considered the following main and subquestions to achieve the research objectives and answer the research problem:

- How can the bidding process be classified and described in the context of a BRIL?
 - How do the different bidding processes work in South African business rescue practice?
- What are the important factors BRPs consider during decision-making to preserve value for creditors and shareholders?
 - How do BRPs identify buyers?
 - What information do the BRPs provide to buyers?
 - What tool is used to leave debt behind?
 - How relevant are pre-pack sales (sales that are negotiated and informally concluded under the supervision of an insolvency practitioner and only formally concluded after formal proceedings commenced and the insolvency practitioner is formally appointed) in South Africa?

It is hoped that the different business rescue bidding processes and associated sale considerations might assist South African BRPs in performing their duties optimally and obtaining the best possible value for stakeholders. At the same time, it may provide local and international investors with a clear understanding of the business rescue sales process when pursuing an investment in a distressed business in business rescue. Lastly, the findings may assist the legislator when updating Chapter 6 of the *Companies Act*.

Literature review

Chapter 6 of the *Companies Act* is silent on any requirements regarding sales of the company using a bidding process.

For this reason, the guidance found in advanced reorganisation regimes elsewhere, namely the United States of America (USA), Canada, the United Kingdom (UK) and Australia, is reviewed to identify bankruptcy sales principles. These principles guide and frame the research in the South African context. The literature review firstly provides an overview of the bidding processes across the four advanced reorganisation regimes. This is followed by key considerations applicable to South African merger and acquisition transactions. The section then defines the market and equitable value and ends with a conclusion.

The quick sale (pre-pack process)

Nocilla (2012) noted that the debtor in control narrative (which suggests that a company and a team of professionals are given plenty of time, patience and sympathy to work out a plan to save a distressed business) is no longer applicable in the USA and Canada. This was replaced by the 'no time to spare' narrative (Skeel 2009). The 'melting ice cube' argument was also used prominently in US cases such as Chrysler and General Motors (Skeel 2009). The 'melting ice cube' refers to a situation where a company, on a daily basis, burns more cash than it earns. Because it loses value, a quickened going-concern sale of its assets is justified (Jacoby & Janger 2014). In both the mentioned cases, the US bankruptcy court approved rapid sales of substantially all the assets of the debtor companies in a restricted bid process. Bruckner (2012) argues that quick sales are the preferred method of selling assets. Currently, pre-packs, where the distressed company organises a sale of all or some of its assets to a buyer before entering a formal business rescue proceeding (Gurrea-Martínez 2021), are not clearly supported by South African legislation (Deloitte 2017). However, Mkhondo and Pretorius (2017) believe pre-packs will probably appear in new business rescue regimes (such as South Africa).

The terminology 'binding agreement', 'purchase agreement' and 'definitive agreement' used in the following literature all refers to sale agreements that the purchaser enters into with the seller (facilitated by an administrator). For simplicity and consistency, the literature review will only refer to the term 'agreement' unless a more descriptive term is justified to describe the process better.

Bidding procedures in the USA

Chapter 11 of the US Bankruptcy Code deals with reorganisation in the USA. According to section 1126, the debtor may approach creditors to propose a reorganisation plan and only afterwards file for bankruptcy. The debtor thus files for Chapter 11 with creditor support for the plan already in place (Mallon & Waisman 2011). According to section 363 of the legislation, a debtor may sell assets without a plan of reorganisation if the debtor can provide evidence that the sale was to preserve the value of the assets.

As per Section 363 of Chapter 11, pre-packaged sales are prevalent because of the speed and flexibility they allow.

Typically, a Section 363 sale would involve a 'stalking horse', or initial bidder, identified by using some marketing process (Ben-Ishai & Lubben 2011:597). The stalking horse enters into an agreement to buy the company's assets, with the understanding that the agreement will be shopped around to other potential purchasers, who will be required to top the deal. The USA has a specialised bankruptcy court which will then be asked to approve the stalking horse bid (with built-in protection for the stalking horse), as well as the auction date and bidding procedures, which set the rules of the auction (Ben-Ishai & Lubben 2011).

Bidding procedures in Canada

The *Companies Creditors Arrangement Act* (CCAA) guides reorganisations in Canada (CCAA 1985). Under the CCAA, quick sale transactions are allowed in the following steps:

1. submission of nonbinding letters of intent or expressions of interest by prospective bidders
2. due diligence
3. submission of binding agreements and deposits by all interested bidders
4. negotiations by the debtor or monitor with one or more interested parties (who are requested to put in their highest and best offers)
5. the selection of the preferred bidder
6. an application to the court for approval of the proposed purchase agreement (which is often sealed and not made part of the public record)
7. court approval of the purchase transaction (without any further auction or the ability of a third-party bidder to make a higher or better offer, should their circumstances or knowledge change).

Unlike in the USA, bid protections are not in place for 'stalking horse bids', and it could, therefore, be more difficult for debtors to attract a favourable starting offer (Ben-Ishai & Lubben 2011:602). Detailed bidding and sale procedures are also absent. Finding other bidders willing to top the initial offer significantly could become more challenging, and auctions are not the norm (Ben-Ishai & Lubben 2011). The appointment of a monitor as an officer of the court to observe and report back to the court on the activities of the debtor is mandatory. This monitor is often the debtor's auditor (Yaad 2008).

Bidding procedures in the United Kingdom

The *Companies Act* of 2006 governs the reorganisation of companies registered in the UK. Reorganisation can be either in the form of saving a business or conducting a sale of its assets for the benefit of creditors, usually to a new company ('newco'). It is, however, the *Enterprise Act* of 2002 that allows for the appointment of a nonjudicial administrator, and the Statement of Insolvency Practice 16 (SIP 16) that provides guiding principles and essential procedures on pre-pack sales in the UK. The administrator gets involved with management prior to their formal appointment in undertaking the pre-pack sale of assets. Creditors may set aside the appointment

of the administrator (Mkhondo & Pretorius 2017). In order to avoid bad publicity and allow the business to continue operations, companies sold under pre-pack arrangements are not publicly advertised (Crouch & Amirbeaggi 2011). After the terms of the sale have been agreed upon, the administrator is formally appointed. The administrator will then immediately sign the contract for sale. Unlike the US court-driven process, the UK administrator will typically sign off on the pre-pack sale on the day of their appointment (Brown 2009).

Bidding procedures in Australia

The *Corporations Act* of 2001 allows for voluntary reorganisation, which can either be rescuing the company or the business. Although no formal legislation exists for pre-packs, the legal structure does allow pre-packaging. Similar to the UK, rescuing the business often happens by selling the assets to a newco – although this practice has been labelled a ‘phoenix scheme’ by some critics (Mkhondo & Pretorius 2017). A phoenix is a creature of mythology, something that bursts into flames and rises again from its ashes. This term has been applied in the context of pre-packs where the sale is made to a newco purchaser controlled by the same directors and/or owners of the existing insolvent trading company. The critique is that it allows the same business and management and/or owners to re-emerge but leave behind unsecured debt (Sidley 2021). The Australian pre-pack sale works as follows (O’Brien-Palmer 2012):

1. The distressed company’s directors employ a reputable valuer to value company assets.
2. Directors arrange a sale transaction based on this independent valuation.
3. The directors appoint an independent administrator, who will examine the transaction as well as the market and report to the creditors.
4. The administrator will only complete the sale if creditor approval is obtained.

Key considerations in a South African context

This subsection briefly comments on key considerations applicable to South African merger and acquisition transactions. The two elements explored below include deal certainty and employment.

Deal certainty

Almost 50% of merger and acquisition deals in emerging markets (such as South Africa) fail (PWC 2017). It is therefore important to understand the deal-breakers and identify the most common concerns that arise postcompletion to provide sound advice to a client (PWC 2017). Because deal certainty in ordinary mergers and acquisitions is already low, one would expect the BRP to consider deal certainty when evaluating buyers using the bidding process in business rescue.

Employment

Loubser (2013) noted that Chapter 6 of the *Companies Act* provides more protection to employees than, for example,

liquidation. An implicit goal of Chapter 6 is that employees’ job opportunities should be protected (Conradie & Lamprecht 2018). Because of the socio-economic problems in South Africa, the BRP is expected to consider employment when evaluating bids.

Market and equitable valuation bases

The International Valuation Standards (IVS), a framework for valuation in markets throughout the world, defines certain valuation bases. Two of these bases are market value and equitable value. Market value is defined as:

The estimated amount for which an asset or liability should exchange on the valuation dates between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion. (IVSC 2017:20)

A ‘willing seller’ in this instance would refer to ‘a seller that is neither an overeager nor a forced seller prepared to sell at any price’ (IVSC 2017:21). In a business rescue scenario, the financially distressed business might be a forced seller rather than a willing seller, so the value obtained in a business rescue scenario may not be a market value.

IVSC (2017) further defines an equitable value as:

The estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflect the respective interest of those parties. Equitable value requires the fair price assessment between two specific identified parties considering the respective advantages or disadvantages that each will gain from the transaction. (p. 21)

The international sources used in the literature review above were salient on whether the value obtained in the bidding processes is a market or an equitable value. During the data analysis process, the researchers considered whether the value obtained through bidding represents an equitable value.

Summary of literature review

Table 1 provides a summary of the bidding principles identified in international pre-packs. This study will build on the existing literature by exploring bidding procedures in, specifically, South African business rescue practice. The principles in Table 1, as well as additional key factors, namely deal certainty, employment and the valuation bases, will guide the interview protocol.

The research design is provided next. This is followed by the presentation of the findings and a summary that outlines the findings. The article then discusses the practical implications of the study, the delineations and limitations of the study and areas for future research. Lastly, an overall conclusion with the authors’ recommendations is provided.

Research design

In this section, the research approach, strategy and method are explained. Table 2 shows the design components, followed by a brief explication of some of the components.

TABLE 1: Bidding principles in international pre-packs.

Principle	USA	Canada	UK	Australia
Asset valuation	Management's valuation. Includes the use of stalking horse.	Management, and assessed by monitor.	Management, with consideration of independent valuator's proposal.	Independent valuator.
Role of creditors	Negotiate with the debtor(s), frequently also a buyer.	Receive notification of sale. Responsibility to prove unreasonableness of transaction in appeal.	Not involved in pre-pack negotiation. May refuse the appointment of an administrator.	Ratifying the sale.
Role of courts	Specialised: sanctioning agreement and process.	Approval and sanctioning.	None.	None – limited to directors' liabilities.
Role of management	Runs the business during the process and appoints a trustee.	Arranges the sale, monitors and evaluates sales and reports to the court.	The management works with an administrator to arrange the sale.	Directors arrange the sale; the administrator completes the sale.
Role of administrator	Trustee negotiates and consummates sales.	None (monitor acts as a watchdog over management).	Leading role in implementing the transaction, end to end.	Ratifies sale with creditors; completes the sale.
Independence of administrators	Appointed by the debtor(s).	Monitor independent.	No role distinction for insolvency practitioners.	Administrator (who investigates the sale) and advisor (who advises management on the process) are two different insolvency practitioners.

Source: Adapted from Mkhondo, S. & Pretorius, M., 2017, 'Pre-packaged applications in business reorganisations: International principles', *Southern African Business Review* 21(1), 98–128
USA, United States of America; UK, United Kingdom.

TABLE 2: Research design components.

Component	Description
Purpose	Exploratory
Research approach	A-theoretical and inductive
Research paradigm	Ontology: constructivism, epistemology: practicality – what works
Research strategy	Qualitative (application of grounded theory principles)
Research question or problem	How can the bidding process be classified and described in the context of a BRIL, and what are the important factors BRPs consider during decision-making to preserve value for creditors and shareholders?
Context	A South African company under business rescue.
Propositions	1. The bidding process can be classified and described in terms of its unique attributes. 2. Factors exist that can preserve value for creditors and shareholders.
Phenomena investigated	The bidding process in the context of business rescue in South Africa
Research method or mode of observation	Interviews
Units of observation	Individual senior business rescue practitioners
Logic linking the data to the propositions	Data collected from the interviews can assist in the classification and description of the various bidding processes and identify other factors that can preserve value for creditors and shareholders
Empirical data analysis	Thematic content analysis.
Criteria for interpreting the findings	Themes can assist in the classification and description of the bidding process and indicate other factors that can preserve value for creditors and shareholders.

Source: Adapted from Mouton J., 2001, *How to succeed in your master's and doctoral studies: A South African guide and resource book*, Van Schaik Publishers, Pretoria; Olalere, T., 2011, *Methodology in accounting research: A critique of taxonomy*, viewed from <https://ssrn.com/abstract=1921192>; Yin, R.K., 2018, *Case study research and applications: Design and methods*, Sage and Saunders, N.K., Lewis, P. & Thornhill, A., 2018, *Research methods for business students*, Pearson Publications.

BRIL, better return than under immediate liquidation; BRP, business rescue practitioners.

Research method

This qualitative, exploratory study used a semistructured interview method to obtain the opinions of 11 senior BRPs. Semistructured interviews provide flexibility (King & Horrocks 2010), which allowed BRPs to explain their personal beliefs and experiences, which may not have been possible if a rigid interview agenda had been used (Stone 2015).

Research setting

Agency theory defines a relationship where the principal delegates a degree of decision-making power to the agent to perform a duty for the principal. However, an agency problem may occur when the principle and the agent have different goals (Jensen & Mechling 1976). In business, an agency problem can arise among the shareholders and

directors of a company or between the shareholders and financiers (Correia et al. 2015).

Previous authors Loubser (2008) and Pretorius (2016), Pillay, Rajaram and Ramnanun (2020) identified an agency problem in business rescue between agents and principals. Although the directors or shareholders (as the principal) appoint the BRP (as the agent), a 'practice principal' appears, namely, the creditor body, which is driven and controlled by banks as the primary creditors (Pretorius 2016:11). While the focus of the study is to explore how the BRP (agent) uses different bidding processes for the benefit of creditors (practice principal) and shareholders (principal) in business rescue, the researchers took note of the agency problem in business rescue. In the section 'Outline of Findings', the researchers conclude whether the findings of this study confirm or deviate from previous studies regarding the agency problem in business rescue.

Entrée and establishing researcher roles

Both researchers have a constructivist ontology, where research participants (BRPs) and their subjective views shape the researchers' understanding of the research phenomena. Research participants offered their views, shaped by their interactions with others and personal experiences. The research findings in this instance were shaped from individual perspectives to broad patterns and, eventually, to broad understandings (Creswell & Plano Clark 2011). Researchers took the role of external researchers, as they are not employed by the research participants (Saunders et al. 2018).

Research participants and sampling methods

Based on seniority, the BRPs were purposefully selected (Rowley 2012) from leading consulting firms. All participants had ample practice in the business rescue field (involved in prominent business rescues in South Africa) and were recognised as frontrunners in the industry by their peers. The 11 BRPs were from the Western Cape and Gauteng provinces of South Africa.

Data collection method

All interviews with BRPs were conducted in person (Rowley 2012) until data saturation was reached (Guest, Bunce &

Johnson 2006). Interviews were, on average, an hour and included various topics. The findings of this study will, however, only focus on the bidding practices identified from the interviews.

Data recording

Interviews were conducted in person and audio recorded. Subsequently to each interview, the researchers wrote down personal reflections of observations made during the interviews (Ritchie et al. 2013; Rowley 2012). Audio recordings were transcribed by a professional transcriber and afterwards verified for accuracy by the researchers.

Strategies employed to ensure data quality and integrity

Participants from 11 different organisations and two different provinces participated in the study, and therefore sight triangulation ensured the credibility of the findings (Shenton 2004). The findings provide 'thick descriptions' of the participants' context, thus ensuring transferability (Lincoln & Guba 1985). A detailed description of the research methods used enhanced dependability (Shenton 2004). The safe storage of all data ensured the confirmability of the findings (Milne & Oberle 2005). The data have been anonymised to protect the personal identifiers of participants and companies related to the participants (Saunders et al. 2018).

Data analysis

The study used the ATLAS.ti software program to open code transcripts into key themes and concepts. The researchers followed an inductive mode of reasoning (Bryman 2012). Researchers were immersed in the data analysis process (Stone 2015) by replaying audio files and reconsidering the transcripts and personal memos while analysing the data. A theme might be unique to one participant's opinion (King & Horrocks 2010). Specific codes were grouped to form a framework based on familiar themes identified from the 11 interviews. The thematic analysis procedures, namely data familiarisation, coding, theme development and revision (Creswell & Plano Clark 2011), provided answers to the research questions.

Reporting style

A theory-building approach (Saunders et al. 2018) was followed in reporting the findings, where the emphasis was placed on the emergence and refinement of the research ideas and the development of themes, relationships and explanations. The theory-building approach was followed to present a compelling theoretical explanation culminating in a framework. The section 'Outline of Findings' will present a framework to emphasise the findings and clarify the message (Quinlan et al. 2018).

Findings

This section provides the findings of the data analysis process. It was found that 10 of 11 BRPs used bidding processes in practice. It indicated that bidding processes are used and

effective. The findings will firstly provide an overview of the different bidding processes used in business rescue in South Africa. Then, it will explain important considerations during decision-making, namely deal certainty and employment commitment. This will be followed by a discussion of where to find buyers, what information to provide buyers, the use of a newco company and the use of pre-packs.

Proposition 1: The bidding process can be classified and described in terms of its unique attributes

The study found that bidding processes can be classified into three distinct types: the highly sophisticated, the less sophisticated and the private bid-out process. The different types of bidding processes are explained in the sections below.

The highly sophisticated bidding process

The first type of bidding process is a highly sophisticated bidding process. This form of the bidding process is often used in the larger and listed type of companies. The highly sophisticated bidding process works as follows:

1. The BRP and/or independent transaction advisor engages with potential buyers and posts a request for expression of interest document on the financially distressed company's website.
2. The respondents receive teaser (high level) information, subject to confidentiality undertakings.
3. The respondents make provisional bids.
4. The BRP and independent advisor consider the provisional bids and prepare a shortlist of preferred bidders.
5. The preferred bidders pay a nonrefundable deposit.
6. The preferred bidders are given access to a virtual data room, conduct site visits to the distressed company's premises and attends presentations by the distressed company's management to enable them to perform their due diligence.
7. The bidders submit final bids.
8. The BRP, company management and the transaction advisor use a *scientific risk evaluation matrix* to evaluate bids scientifically and select the final preferred bidder.
9. The BRP incorporates the best bid into the business rescue plan.
10. The creditors vote on the business rescue plan.

An interesting observation was the point (9), namely that the *best bid*, and not necessarily the highest offer obtained, is included in the business rescue plan:

'The largest one isn't always the one we will accept' (BRP4, June 2018, Attorney).

The factors considered by the BRP to decide on the best bid are discussed in more detail below in the section on the findings of proposition 2.

The less sophisticated bidding process

The second type of bidding process identified was less sophisticated than the bidding process explained above.

This type of bidding process is often used in smaller business rescues. The BRPs do not usually employ transaction advisors in this bidding process. Company information is not presented in virtual data rooms but in the form of printed information packs and discussed with the buyers in person. The less sophisticated bidding process works as follows:

1. Potential buyers approach the BRP (through word-of-mouth or in reaction to an advertisement).
2. The potential buyers pay a nonrefundable deposit and receive an information pack containing data on the financially distressed company.
3. The potential buyers submit offers in a tender box at the offices of the BRP.
4. The BRP decides on the best offer and includes it in the business rescue plan; alternatively, the BRP will summarise all the offers and present them to the creditors or creditors committee.

Although the level of sophistication of the two tender processes explained above varies, BRPs usually do not use a 'horse-trading' process where different investors bid against each other. Business rescue practitioners require nonrefundable deposits to ensure that only serious buyers participate in the tender process:

'We learnt the hard way over the years that if you put this out there and you don't ask for a payment, then every Tom, Dick and Harry comes in and wants information.' (BRP10, June 2018, chartered accountant)

'We try and trash out charlatans, of which you always get a group of people coming along, just pretending to be bigger boys than they actually are.' (BRP2, June 2018, chartered accountant)

Some participants believe that a bid-out process could work effectively in business rescue. The next section elaborates on a bid-out process that maximised the business rescue value in the past.

The private bid-out process

The private bid-out process entails carefully selected buyers coming together, and then the BRP himself or herself or an experienced chairman facilitates the bid-out process. A descriptive example of a private bid-out case study is presented in Example 1, using the direct words of BRP1 to allow the reader to enjoy the richness of the explanation.

It is evident from Example 1 that the bid-out process resulted in the final price being significantly higher than what the BRP had anticipated, thus indicating the potential of using private bid-out processes to maximise the business rescue value. This finding supports previous research by Conradie and Lamprecht (2022), who statistically analysed offers made by buyers and book values of assets and found that a private bid-out process resulted in a business rescue value higher than the mean offer of the sample.

Most participants stated that, for bidding procedures, a standard tender document was not provided to bidders beforehand, and the offer terms and conditions made by the

BOX 1: Example of a private bid-out process.

'We agreed on a process where we had a bid-out in a council hall in Johannesburg. We identified three parties [*bidders*]. Each party had to pay an [*R amount*] million deposit in the attorney's bank account just to participate in the process. We appointed an independent chairman to facilitate the process. We started at 10:00 on a Friday – it was [*Date*]. We thought we would finish by 13:00 and go for lunch and play some golf in the afternoon.

The process worked as follows: they [*the bidders*] have a form, then they have to say what they are bidding, and they must close the form and put it in an envelope. Then the chairman opens the envelopes, and he will say A is the highest, B is second and C is the lowest. But no one knows what the other's bid is. The chairman will ask: 'Are you all still in?' They will respond: 'Yes, we're in!' They then go away. Five minutes later, they return with their envelopes. The Chairman opens the envelopes again. Then he says, 'OK, B is first now, C is second and A is last,' but they still do not know what the others are paying. Then they go back, and so we went on...

After about 14 rounds, 15:00 that afternoon, one party came and he jumped with almost [*R amount*] million in front of the others. After that, we went on for 20 laps, where this party was the highest, but the other parties come up just [*R amount*] million at a time. Eventually, another one passes by. I had a flight 17:00 that afternoon, so half past three I said I had to catch the Gautrain now, I'm going to fly. While I'm on the Gautrain, I received a WhatsApp on the different amounts for the different parties. When I landed at 19:00 and drove from the airport, they were still busy on that Friday night. They finished 21:00 that evening, 52 rounds later.

We received [*R amount*] million for the business, initially only valued at an Auction value of [*R amount*] million! [*Authors' note: The amount received was 15 times more than the auction value.*]

This gives you an example of how you should literally be creative in these processes, but you cannot do that unless you have enough oxygen in the tank to keep the business going. We've produced enough to maintain our monthly costs and to get to that point where we could sift the market to get the right parties.'

Source: BRP1, May 2018, attorney
BRP, business rescue practitioner.

bidders may therefore differ significantly. In such instances, the BRPs and transaction advisors must evaluate the bids based on quantum and risk, as is explained in more detail in the following section.

Proposition 2: Factors exist that can preserve value for creditors and shareholders

Deal certainty, employment commitment and the risk evaluation matrix

When analysing different bids, the BRP considers the value of the offer, together with the restrictive conditions in the offer and the perceived risk of the transaction. The bid the BRP finally chooses to include in the business rescue plan will not necessarily be the highest offer in terms of nominal value. A prevailing consideration, namely deal certainty, was found to be more important in business rescue than in ordinary mergers and acquisition transactions:

'Deal certainty is absolutely fundamental. You don't have the luxury of time, so you'll always be looking for a bird in the hand, even if it's not the two in the bush.' (BRP5, June 2018, chartered accountant)

Because deal certainty is such an important consideration, the scientific risk evaluation matrix used in the more sophisticated bidding processes appraises the risk of each potential bid. The types of risks considered in the risk evaluation matrix include the following:

- the ability of the bidder to pay the purchase price (reputable bank guarantees, bid supported by buyer's strong balance sheet and capital raising requirements)
- implementation risk (relative sophistication of buyer, the operational track record of the buyer, South African presence and the complexity of bid)

- the time period necessary for signatures
- employment commitment.

Buyers might come from across the world to bid on financially distressed assets, especially if it is a big company in business rescue. When the buyer universe is very broad, the level of buyer sophistication varies. If the buyers are international buyers, there is a risk that they may not understand South African regulations, which increases risk and reduces deal certainty:

‘The Chinese, you cannot for a moment think they’re unsophisticated, but they can be very opportunistic. They might be rolling in a bowl of cash, but the bids that are coming are actually a disgrace. And then you get a bidder who is familiar with the environment and understands SA mining and everything that goes with it. They’ve seen these deals go through in business rescue in the country before, you kind of learn from them and they know where to pitch it. So, bidder sophistication is a huge issue. The Chinese can have a million minions sitting in an office, building the most impressive spreadsheets and calculations you’ve ever come across in your life, but when it comes to doing work in South Africa, they are not so good in implementing. You go like, “Do you guys know that you need to have a BBBEE partner? We’ve put it in the data room.” “Ja, ja, ja, we’re busy negotiating with somebody.” You go like, “Really? Out!” We don’t have time for that. We just do not have time.’ (BRP5, June 2018, chartered accountant)

Previous studies criticised Chinese investors for their lack of sustainable business practices and alleged underbidding for tenders (Alden & Davies 2006). Buyer sophistication is, therefore, an important consideration when choosing the best bid to ensure that implementation risk is reduced.

Participants indicated that the employment commitment of potential buyers is included in the risk evaluation matrix because of the importance of employee retention, specifically in South Africa. This is also one of the reasons why some BRPs (with their advisors) choose the final bid and do not leave the choice to the creditors:

‘From an African perspective, if you do not retain employment, the burden on the taxpayer becomes too much. So crucify me for that, but that is more important for me. So when I look at offers, people who contain the most employees and still have a viable business – because you must remember, they come with a huge price tag – those most probably would be the ones that I would choose.’ (BRP4, June 2018, lawyer)

Since the buyer, through the bidding processes, ultimately determines the value of the business, the next section elaborates on where BRPs find buyers for financially distressed companies.

How to identify buyers

Participants indicated that, typically, potential buyers approached them. Alternatively, BRPs find the buyer within the value chain of the financially distressed company:

‘They come to you, to be quite honest. When the rescue starts and you are appointed, the phone starts ringing. So what we do is we record all interested parties that buzz onto the radar. When

we appoint an independent transaction advisor, we provide them with the contact details of all the interested parties that have contacted us directly, and they then have the mandate from us to put it out into the market as well via their networks.’ (BRP6, July 2018, business administrator)

‘You normally find it in the value chain.’ (BRP7, July 2018, professional accountant)

Although the study found that buyers are usually strategic trade buyers who can utilise the financially distressed company upwards or downwards in their value chain, financial buyers might also be interested. The price offered and the resultant business rescue value would, as explained below, depend on whether the buyer is a trade or financial buyer:

‘If there’s a financial buyer, he says, “I like the business, I like Pringle shirts, I have to buy a buyer, I have to buy an accountant, I have to buy an IT system, I have to buy all of those.” Whereas if it’s an existing business, you can just bolt it on. So trade buyers versus financial buyers make a massive difference in the price they offer.’ (BRP5, June 2018, chartered accountant)

From the findings in the previous sections, it is concluded that the business rescue value in the business rescue plan tends to be an equitable value, as defined by IVSC (2017), as it comes down to the price that is fair between two *specific* identified parties, and usually not a general market participant. Although in many cases, the price that is fair between two parties will equate to that obtainable in the market, there will be cases where the assessment of equitable value will involve taking into account matters that must be disregarded in the assessment of market value, such as certain synergy benefits (IVSC 2017).

The next section elaborates on the information given to potential buyers.

Information is given to buyers that may influence bids received

Participants indicated that they tend to be transparent and provide as much detailed information as possible to potential buyers. The information would include, for example, historical financial data, sales trends, legal documents, employment records, customer base information, profit margins and a comprehensive list of company assets. In the event of unaudited management accounts, participants indicated that they would verify (e.g. do a stock take) and sensitise (e.g. write off doubtful debtors) management accounts but that ultimately buyers have to perform their due diligence to obtain re-assurance of asset values:

‘You’ve got two choices; you can focus on what’s gone or what’s coming, and typically I will focus on what’s coming. Typically, buyers are not coming to look at it for what it did in the past. The past is interesting but mildly. Management accounts will take care of themselves in time.’ (BRP9, July 2018, chartered accountant)

This study and previous research by Conradie and Lamprecht (2021) indicated that it is best not to disclose the liquidation

value to a potential buyer. However, BRP5 remarked, 'if it's in a business rescue plan, it's generally publicly available'. Thus, the authors conclude that it depends on whether the BRP publishes the business rescue plan before or after the BRP has contracted the buyer. Most participants indicated that they requested an extension from the creditors to publish the business rescue plan. The BRPs then first found the buyer(s), incorporated the preferred offer into the business rescue plan and then published the plan, while some participants published an initial plan without the inclusion of a binding offer from a buyer. The plan then showed only the liquidation value and a proposal by the BRP to find a suitable buyer for the business. If the potential buyer came from the value chain (e.g. a supplier who is also one of the creditors), this buyer-creditor would have had access to the liquidation value. The timing of when the BRP publishes the business rescue plan is thus an important consideration from a value perspective. A salient theme identified was that a BRIL plan without a binding offer is not a good plan. It seems a better practice is to follow the first scenario, in other words, to publish a plan after the BRP has received a binding offer.

Creating a new company

International authors Wessels and Madaus (2018) indicated that a business rescue sale requires a tool to leave debt behind. The tool that both the UK and Australia use is the creation of a newco company (Mkhondo & Pretorius 2017). Participants in this study agree that the BRP may add value for the potential buyer by improving the state of the financially distressed company for the buyer. Similar to the UK and Australia, when selling financially distressed companies in South African business rescue, some BRPs transferred the company's assets to a new company, known as the newco, after the creditors have been paid and retrenchments have been made. The old debt is then gone, and the investor may go on with the business debt-free:

'We do stress [to buyers], whatever deal you do, all the creditors are gone, you buy a debt-free business because we give it to you debt-free.' (BRP9, July 2018, chartered accountant)

'We present an opportunity [to the buyer]. I will do the retrenchments that you want to be done. So I can change the company to the best form for you to extract value as long as you give me a better return.' (BRP3, September 2018, management accountant)

Since some form of pre-pack may be used when selling a distressed business in business rescue (Mkhondo & Pretorius 2017), this study considered how potential pre-packs influence the sales process. The results are presented in the next section.

The use of pre-packs in South Africa

Internationally, pre-packs often occur in reorganisation. The pre-pack driver is sale-based in the UK, Australia and Canada (Mkhondo & Pretorius 2017). Because the pre-pack is sale based, an asset valuation is performed. In South Africa, the definition and process of how a pre-pack should work are undefined in the *Companies Act*. Nonetheless, all participants in

the study indicated that they would like to see pre-packs incorporated into the *Companies Act* because they believe this may add value to the business rescue process. The authors found that the need for a pre-pack in South Africa is not necessarily sale driven, as was the case with the classic international pre-packs mentioned above. Instead, the need is to allow for *pre-involvement* of the BRP with the financially distressed company before business rescue commences. This would enable the BRP to perform a proper pre-evaluation of the business to determine the reasonable prospect of rescuing the business – which is currently very difficult, given the short time frame available to the BRP. In addition, this would also help to preserve company value because it will allow the BRP to pursue a restructuring type of business rescue more often:

'I would like to see it [a pre-pack] there [in the Companies Act]. I think it makes absolute sense for a practitioner to come in, advise directors on their company, set up something, assess whether business rescue can work or cannot work. Too often – practically, how it works is you get a phone call on a Friday afternoon – either from a bank or a creditor or maybe a director – saying the company is going into business rescue, we're signing the resolutions this afternoon and sending it off to CIPC, will you take it. And I know nothing about the thing [company]. Therefore, many times I say no thank you, unless you can come and sit with me over the weekend and let us have a look at your financials and things. Because with all respect, I think you have 5 days, from appointment to the first meeting, to take a view as to whether you can save the thing [company]. That's ridiculous.' (BRP5, June 2018, chartered accountant)

'If we had time a month before it went into business rescue to engage with suppliers and customers, I believe we could have got a better result than we did. It lends itself to a pre-pack. Maybe not a pre-pack, but a pre-involvement, so that when it went in, you could actually trade it. The reality was that we went in, it was a shock deluxe to everyone, and it was like water running through your fingers. But if one had a chance to engage with critical suppliers, critical customers, and critical financiers before I get their support for it, there would have been a better chance of it working.' (BRP2, June 2018, chartered accountant)

Only four of the BRPs indicated that they had never been involved in a pre-pack in South Africa, while the other practitioners indicated that they had used pre-packs (or rather *pre-involvement*) in South Africa in particular cases:

'So we do everything, we prepare a plan beforehand, and then go in [business rescue].' (BRP3, June 2018, management accountant)

'I'll raise everything; everything is ready, OK, the funding, the transaction is ready to happen. Then we put it into business rescue, and then we do put all the ribbons on in business rescue.' (BRP7, July 2018, professional accountant)

Business rescue practitioner 5 had used a pre-pack in South Africa as a strategic tool to perform a workout with creditors. The company never went into business rescue; business rescue was used only as a threat:

'So in other words, you [the BRP] have identified the buyer; he likes the asset, but there is too much debt in it. Company C is an example. The business was good; it was generating R3 billion

worth of EBITDA, horrendous cash conversion, but R3 billion of EBITDA, but it had R25 billion of debt. And to stick that into business rescue, the R3 billion would evaporate in a second, because prepaid cell phone customers change tomorrow because it's raining and Company M has got a better deal, and that was the majority of the customers. So a formal process was just going to see an evaporation of value. So we certainly took a view to say, "Right guys, let's use the threat of a business rescue as a pre-pack." The process happened outside of business rescue. There was a threat of business rescue to come in. There was a buyer who came and said, "I'm prepared to put X amount of cash into the business, you guys [creditors] can split that cash amongst yourselves." (BRP5, June 2018, chartered accountant)

The main advantage of pre-involvement (in addition to enabling the BRP to perform a better assessment of the reasonable prospect of the business) is the shorter time the company would have to spend in business rescue (BRP1, 3, 6, 7). Shortening the length that the company spends under business rescue will reduce the costs of financial distress such as loss of reputation, employees, suppliers, consumers and goodwill. Thus, pre-packs can help maximise the value of the firm for the benefit of creditors and society as a whole (Gurrea-Martínez 2021).

Although BRPs supported the notion of pre-packs, some emphasised that there were also risks involved. The BRPs noted the need to be transparent with creditors, the BRP fee should be agreed upon upfront, and the BRP should know and trust the previous advisors involved until the BRP commences:

'If it's done incorrectly and not in the best interest, you can create a lot of animosity amongst your creditors. It all has to be transparent.' (BRP2, June 2018, chartered accountant)

'So if the pre-pack comes to me in a potential business rescue, and the pre-pack had particular institutions involved in trying to cobble together a pre-pack, then it's okay nine times out of 10 times. But you must know these people. You have to have been

in this industry to understand who the guys are that play in the game.' (BRP6, July 2018, business administrator)

To summarise, BRPs in South Africa do not use pre-packs to sell assets outside of business rescue. Some of the BRPs used pre-packs in the sense that they were *pre-involved* with critical suppliers, creditors, possible postcommencement financiers, etc., before the company filed for business rescue. In such an instance, the pre-pack was therefore not sales driven but driven by the need to conduct a proper pre-assessment of the company, assess creditor support for business rescue and test the availability of postcommencement finance (PCF). In contrast to international pre-packs, independent valuers are not involved in pre-pack asset valuations in business rescue in South Africa. Table 3 is a duplicate of Table 1. The table, originally from Mkhondo and Pretorius (2017), was amended by adding information about South Africa in the last column of the table, based on the findings of the study.

Outline of the findings

Figure 1 provides a framework of the three bidding processes used in business rescue practice, namely sophisticated bidding, less sophisticated bidding and the private bid-out process. It also illustrates the important factors that can preserve value for creditors and shareholders.

The authors considered the agency problem that might appear during the bidding procedures and identified two aspects that could potentially threaten the principle-agent relationship. These two threats occur during the *recruitment of buyers* step and the *evaluation of offers* step of the bidding process. If, during any of the three types of bidding procedures, the BRP only identifies buyers through his or her personal networks and not through public advertisement, it creates the risk that the BRP might sell the financially distressed business to a connected person at a value that is

TABLE 3: Asset valuation in international quick sales, including South African sales.

Principle	USA	Canada	UK	Australia	South Africa
Asset valuation	Management's valuation. Includes the use of stalking horse.	Management, and assessed by monitor.	Management, with consideration of independent valuator proposal.	Independent valuator.	When selling a company, the strategic buyer determines the company's value. Bidding processes are often used.
Role of creditors	Negotiate with the debtor(s), frequently also a buyer.	Receive notification of sale. Responsibility to prove unreasonableness of transaction in appeal.	Not involved in pre-pack negotiation. May refuse the appointment of an administrator.	Ratifying the sale.	BRP may involve major creditors in pre-business rescue negotiations to ascertain support for business rescue because creditors need to approve the plan. Creditors (e.g. suppliers of the company) are often also the buyers.
Role of courts	Specialised; sanctioning agreement and process.	Approval and sanction.	None.	None – limited to directors' liabilities.	No specialised court involvement concerning the valuation of assets.
Role of management	Runs the business during the process, appoints a trustee.	Arranges the sale; monitors, evaluates sales and reports to the court.	The management works with an administrator to arrange a sale.	Directors arrange the sale; the administrator completes the sale.	Runs the business during the process and appoints the BRP.
Role of administrator	Trustee negotiates and consummates sale.	None (monitor acts as a watchdog over management).	Leading role in executing the sale process, end to end.	Ratifies sale with creditors; completes the sale.	BRPs, sometimes assisted by independent advisor, facilitate communication between company, buyers, employees and creditors. BRP selects preferred buyer, then incorporates transaction into a plan for creditor approval.
Independence of administrators	Appointed by the debtor.	Monitor independent.	No role distinction for insolvency practitioner.	Administrator (who investigates the sale) and advisor (who advise management on the process) are two different insolvency practitioners.	Appointed by directors or court.

Source: Mkhondo, S. & Pretorius, M., 2017, 'Pre-packaged applications in business reorganisations: International principles', *Southern African Business Review* 21(1), 98–128, adapted by adding the authors' findings at end of the table.

USA, United States of America; UK, United Kingdom; BRP, business rescue practitioners.

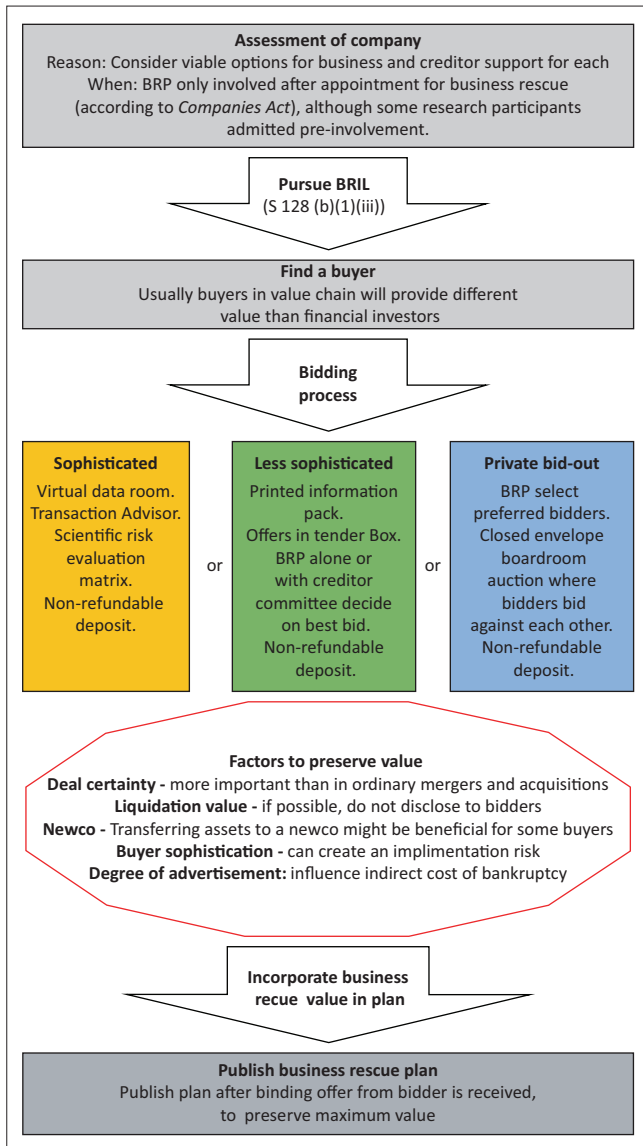


FIGURE 1: Framework of the bidding processes used in business rescue in South Africa.

less than what a general market participant would have paid. This risk is increased when the BRP evaluates offers from potential buyers in private without disclosing all offers to creditors. Although the researchers identified the risk as a possible threat to the principle-agent relationship, the possibility of the risk realising is deemed low. This is because BRPs indicated that bids are evaluated with the help of a transaction advisor (in more formal bidding procedures) or with the help of fellow team members (in less formal bidding procedures). In addition, it was clear that the main reason why a financially distressed company is sometimes not publicly advertised is to limit the indirect costs of bankruptcy. Business rescue practitioners indicated that acting unethical would cause damage to themselves and their employers' brand names, and they would therefore not consider it.

Practical implications

This research identified and described three different bidding procedures used in practice by senior BRPs. It emphasised

factors to preserve value for creditors and shareholders, such as where to find buyers, deal certainty and employment consideration and the use of newco companies. Business rescue practitioners are also advised not to disclose the liquidation value of the company before a binding offer is obtained. These findings can guide the business rescue industry in the absence of explicit bidding guidance by the *Companies Act*. Business rescue practitioners expressed the need for pre-involvement in business rescue – the legislator can consider this in future amendments to the *Companies Act*.

Limitations, delineation and possible future research

This study was conducted before the global COVID-19 pandemic. It is, therefore, possible that BRPs might have slightly adapted their bidding strategies and moved to a more digital approach. The less sophisticated tender process that involved closer contact with potential buyers might have been used less than the more sophisticated process, which involved more online sharing of information. Face-to-face sessions with management, all-night boardroom negotiations and travelling for due diligence investigations might no longer be possible. Most of the buyer's due diligence process would probably be conducted remotely through virtual data rooms.

Matters concerning labour relations are important, and the BRP should execute the bidding process in compliance with all applicable legislation. Apart from the earlier recognition that job security is important in a business rescue, further matters concerning labour relations fall outside the scope of the paper. In addition, some of the bidding procedures used for BRIL under business rescue might be used in liquidation. However, investigating auctions at a procedural level, as applied under liquidation, falls outside the scope of this study.

Business rescue practitioners expressed a need for amendments to the *Companies Act*. Research into exactly how to amend the *South African Companies Act* to allow for pre-packs, based on a thorough analysis of the advantages and disadvantages of international practice, could be beneficial to the business rescue industry in South Africa. Future research may also investigate which of the three bidding processes identified in this study maximises value in business rescue.

Conclusion

Because of the absence of strict bidding regulations in Chapter 6 of the *Companies Act*, BRPs use their freedom and apply different bidding procedures when selling companies in business rescue. Although the procedures seem to work well in practice, one should consider how these practices could be improved to maximise the business rescue value. For instance, when bidders pay a nonrefundable deposit, BRPs argue that this is a measure to ensure that only genuine interested buyers are provided sensitive company information. However, if the required

deposit is too high, it might also mean that not enough buyers are offered the opportunity to partake in the sale. Also, the BRPs' degree of advertisement is different. Often the business is not publicly advertised to avoid the indirect costs of bankruptcy (Rosslyn-Smith, De Abreu & Pretorius 2019). Although BRPs indicated that they are very transparent with creditors throughout the sales process, the insufficient advertisement might lead to fewer buyers and, as a result, a less than optimal business rescue value (if one assumes that more buyers equal a higher demand and thus a higher value). The little advertisement might also create an objectivity threat if the buyer comes from the BRP's personal network of investors and increase the agency problem in business rescue.

This article provided a framework to classify and describe the various bidding processes used when selling financially distressed assets through a business rescue in South Africa. Although the absence of proper bidding guidance in Chapter 6 provides BRPs with the freedom to be creative, it also creates possible threats, which the South African legislator should consider in future Chapter 6 amendments.

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Authors' contributions

S.C. and C.L. planned the study and selected the research design together. S.C. collected and analysed the data and wrote the first draft of the article. C.L. provided guidance on the research method and reviewed the research article.

Ethical considerations

Ethical clearance to conduct this study was obtained from the Stellenbosch University Research Ethics Committee: Humanities (ref. no. ACC-2018-6328).

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Data availability

The data that support the findings of this study are available on request from the corresponding author, Mrs S Conradie. The data are not publicly available because of privacy of research participants.

Disclaimer

The views and opinions expressed in this article are those of the authors and do not necessarily reflect the official policy or position of any affiliated agency of the authors.

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