Restructuring & Insolvency

Restructuring & in solvency in the UK

The general consensus among turnaround specialists and insolvency practitioners in the UK is that things are a little quieter than they might be, given the depth and intensity of the current recession.

There were 5,055 compulsory liquidations and creditors voluntary liquidations in total across England and Wales in the second quarter of 2009, according to official figures from The Insolvency Service. This was a 2.9% rise on the previous quarter and an increase of 39.1% on the same period last year. Bolstering these statistics, figures for the 12 months ending 30 June 2009, show that one in 120 active companies went into liquidation, which is up slightly on the previous quarter when the figure was around one in 130.

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Despite the slight increase in the number of failing businesses things aren't looking that bad, considering the context of the current economic downturn. There are several possible explanations behind the slightly lower than expected numbers of insolvency cases; the first being that corporates are restructuring operationally and financially in order to cut costs, reduce interest burdens and generally ride out the recession. However, a significant reason behind lower than expected insolvency figures could be the Government's tax deferment scheme. As with all controversial decisions, there is a debate brewing as to whether these agreements are storing up significant debt problems for already weak businesses

The Government has made a strong effort to reduce support SME businesses by, putting pressure on banks to retain existing, and extend new lending, facilities to business customers. The Bank of England has cut the base rate to 0.5% and HM Revenue & Customs (HMRC) has introduced time to pay arrangements for Crown debt. However, the duration of this favourable set of circumstances will not be indefinite and many businesses could find themselves facing the fresh risk of insolvency once they have come to an end

There may be trouble ahead

A recent survey from the Association of Business Recovery Professionals, R3, reveals that 95% of its UK membership fears that the full impact of the recession has yet to be translated into official insolvency figures. This concern is borne out by statistics from the last recession, when corporate insolvency procedures peaked in 1992 - three years after the recession had started.

HMRC's time to pay arrangements have been extended to more than 168,000 businesses and tax are now approximately £30 billion, including corporation tax, VAT, and PAYE. Andrew Duncan, partner at Bridge Business Recovery, believes that distressed businesses are unlikely to feel the pressure of higher interest rates in the near future as the Bank of England will be forced to keep its base interest rate low.,

Mr Duncan said: "In the short term, I don't think interest rates are a major threat to businesses, as I can't see them going up any time soon. Nevertheless, banks have reassessed their price and risk policies and, as a result, the cost of borrowing has increased."

On the subject of deferred tax bills for cash-strapped companies, Mr Duncan predicts that all good things must come to an end and that it is only a matter of time before these arrangements conclude, causing a dramatic rise in corporate insolvencies.

He said: "It wouldn't be an overstatement to say that HMRC has been giving almost everyone who asked time to pay since late last year. HMRC has approximately £30 billion in outstanding taxes due (and has written off around £11 billion). The Treasury's tax take is down significantly and HMRC is going to have to start collecting soon to enable the Government to continue to finance UK Plc."

He added: "There has clearly been a hardening of HMRC's attitude and we are starting to see an end to deferment schemes. This will precipitate a number of business failures, which will subsequently force the hands of the banks, because the last thing they will want to do is to allow HMRC to place companies where they have an exposure into an insolvent liquidation resulting in the destruction of any enterprise value. The High Street banks will be compelled to step in and exercise their debenture security. In my opinion, the Government's actions have allowed companies that are probably insolvent to delay the inevitable, rather than be able to address their financial difficulties. Unless the economic outlook changes fundamentally, which is unlikely, it's difficult to see how these businesses will survive."

Richard Curtin, of law firm Faegre & Benson LLP, says the potential for a Conservative Government next year will only add to the speed with which generous Government schemes are withdrawn, as David Cameron looks to get the public debt burden under control quickly.

He said: "The actions of the Crown will be interesting. We have a general election coming up soon and the new Government will have big bills to pay with depleted revenues because less tax is being paid as companies go bust. They will certainly tighten up soon on the time-to-pay initiative."

These sentiments are supported by Matthew Barker, IP Partner at law firm Clarke Willmott. He believes that lenders have been far more supportive of their customers than in the early nineties recession.

He said: "Lenders and HMRC have been very flexible in allowing businesses time to pay outstanding tax, so less corporate failure has occurred than might have been anticipated. Cash has continued to be cheap, which has also enabled more businesses to survive. It may well be that lender and HMRC strategies may harden and inflation may return, which could lead to increased cash pressures on businesses and large numbers of failures."

Avoiding insolvency

Despite the fact that many businesses are teetering on the brink of insolvency, there are ways to bring a business back to health without entering the costly court-driven insolvency process.

As finance is still very difficult to secure, the best and most immediately effective way of doing this is to address cash management.

Matthew Barker says that different businesses face different challenges but that some main principles for management apply to all. He said: "Businesses must devise and stick to a coherent strategy, use real time financial information, focus on cash management and profitability, rather than turnover, address under-performance issues early, whilst they still have breathing space and be realistic, taking early advice and following it."

He added: "Market conditions are tough and most IPs anticipate an increase in failures in 2010. Directors have a very difficult balancing exercise to juggle, when trading a business in distress. They have to act in the best interests of a number of different categories of interested parties, where there may not be a commonality of approach. Hence, the right advice is crucial."

Richard Curtin, from Faegre & Benson, believes that an inventive and practical approach to raising finance will usually work, even in a tough debt environment, since banks are still open to solid propositions.

He said: "Negotiating with banks is always fun and games, they are still cautious and many of them are not the institutions they once were, particularly the one's that received a public bail out. They are still open for business, but you have to be inventive, practical and creative when raising finance. It's out there, but not so easy to find."

The idea of innovative funding is also backed by Alain Le Berre, from Huron Consulting Group. He says there are new routes of funding becoming available as traditional funding sources dry up.

He said: "Innovative funding is the order of the day, at times when traditional financing routes seem to all but dry up. The good news is that new solutions are emerging, that can help solve otherwise tricky situations. They include debt-equity swaps; asset-based lending; accelerated asset disposals; debt buy-backs and/or new money from shareholders or debt restructurings. Innovation is more crucial than ever because the old and tested ways to do things are not working anymore. The international dimension of any funding solution is also becoming ever more important."

Mr Le Berre adds that a successful restructuring has to be holistic and encompass operational, managerial and financial as well as debt issues.

He said: "It is key to understand that a "siloed" approach will not work. Distressed investors with experience of at least one cycle have realised that conducting a debt restructuring alone is not enough. They now realise that a successful restructuring approach has to be "holistic" encompassing operational, managerial, financial as well as debt restructuring issues from an integrated perspective. Ultimately, the successful investor will be the one which has left no stone unturned in his/her quest for value and his/her understanding of all relevant risks in order to put in place appropriate mitigation plans."

Peter Sargent, President of R3, says distressed businesses must return to running their businesses with more prudence if they want to avoid insolvency.

He said: "Cash flow is a problem if you are close to or are bumping into your overdraft limit all the time. Businesses need to take a close look at their aged debtors analysis and ask what they are doing about pulling in outstanding book debts, they also need to step back and look at the order book and work towards turning them around as quickly as possible. Keep an eye out for the build up of your own creditors especially crown debt, make sure you pay over the monies you deduct from people's salaries to the appropriate departments, including PAYE, NIC and pension contributions on time, but if there cash flow problems talk to HMRC and trade creditors, creditors would rather be paid late than not at all.

He added: "Over indebtedness is also a problem, I tend to deal with small to medium sized businesses that are mainly family owned. It can be a good idea to replace bank borrowing with family investment, or put something back in yourself if you really believe in your business. Leaving money in the business so it has some wool on its back to get through the difficult times is crucial."

Andrew Duncan, from Bridge Business Recovery, suggests that many companies that appear to have sound underlying business fundamentals may have a number of issues that will need to be addressed if they are to survive and prosper.

He said: "There may be legacy issues, such as management problems, vendor loans, defined pension schemes or huge revenue debts. If the incumbent funder decides it isn't prepared to extend its lending, as there are concerns regarding its security position, the management team, a VC or another investor, will need to step in, secure new facilities and inject new monies to drive the business forward."

An increasing role for CVAs

The Company Voluntary Arrangement (CVA) is available to small and medium businesses in the UK as a way of avoiding the costly process of a formal insolvency. It is a process, overseen by an insolvency practitioner, which aims to gain the buy-in and consensus of all creditors to contractual