Business Rescue & Survival Guide

Or how to close down your company the right way – if you do not want to explore continuation of trade options

Don't let problems creep up on you

It is rare that directors or business owners wake up one morning to find that disaster has suddenly struck. Financial problems tend to be insidious. Indications that something is wrong may be more obvious to others than they are to you.

When you are busy firefighting and juggling creditors it is understandable that you might fail to spot the warning signs. If you are in any doubt please consider the following warning signs. Invariably the earlier you seek help the more that can be done to help and recognising warning signs early will give you the best possible chance of avoiding insolvency.

If any of these factors apply to you…..

- Your business is running out of cash
- You are thinking of injecting emergency funding or perhaps giving a last chance PG
- You feel like your business is being run into the ground
- You are concerned you might unintentionally do something that could give rise to director disqualification
- Or if business pressures are getting you down

….. then contact us for advice. At an initial meeting suggestions to ease cashflow, how you could safely inject working capital, how to avoid wrongful trading as well as how to protect your entrepreneurial future can be discussed – but don't delay. If action is taken early there is often a good chance that your business can be saved. However, once decline has set in the chances of success become more remote and formal insolvency can end up being the only option.

Warning signs to look out for

It's often said that the spectator sees more of the game. As specialist business rescue and insolvency practitioners we can spot the warning signs when you might be too close to see the dangers.

Use our traffic light systems below to self-diagnose your situation.

Green
Carry on trading but keep under review

- Unable to pay creditors on normal terms but they are happy to extend further credit.
- Cannot pay the tax man on time but HMRC has agreed a payment schedule for the arrears.
- Exceeded your credit limits with your key suppliers and you are on stop but you are able to get credit elsewhere and overall keep your creditors level.

Amber
Proceed with caution

- You can only get credit from new sources and are using this to fend off existing creditors.
- Creditors are threatening legal action and tax arrears are mounting.
- You cannot accept new orders because you cannot buy essential materials or pay the overtime to satisfy it.

Red
Stop trading or take professional advice

- You are on stop with most of your suppliers and cannot get more credit from anywhere.
- You are receiving final demands for payment and county court writs.
- The worry is giving you sleepless nights.

Free online Business Health Check

If you are still unsure of your next steps complete our free online Business Health Check https://www.mw-w.com/business-healthcheck - this tool will let you know if your business has what it takes to thrive and survive.

What happens if my company cannot be rescued?

Company insolvency is needed when a company has net liabilities, when it has reached the point of no return or cannot pay debts when they fall due – and is insolvent. As soon as this happens directors of the business should take advice from a licensed Insolvency Practitioner ("IP") because:

- The situation will impact how the business should be run
- It is sometimes possible to trade out of the situation if advice is sought early enough
- There are strict penalties for getting it wrong that IPs can help you avoid

It is important to remember that directors of an insolvent company have a legal duty to act in the best interests of creditors and need to be careful to avoid wrongful trading and personal liability or other misconduct that could lead to disqualification. This may sound worrying but an IP can assess your situation relatively quickly and give you the guidance you need.

During a discussion they can talk through all the business rescue options and if necessary the insolvency options such as the following.

Trade on and out

Prevention is better than cure.

If a company can avoid having to break cover and compromise with creditors then it should. It is not unusual for businesses to have to juggle cashflow for short periods but not all the time

As a company becomes distressed it usually happens slowly over a long period until towards the end when it becomes rapid and directors have to fight on multiple fronts – for example when credit insurer's withdraw. If the decline is not just about cashflow and revenue and costs need to be re-aligned then cut early and hard so you start to see the benefits quickly.

Don't be optimistic. Make sure forecasts are brutally realistic otherwise you might pursue this option when another business rescue option is more appropriate. If cashflow is tight prepare a rolling 12 week or short-term daily cash forecast so you understand the cash position through-out each month end.

If your clients are thinking of introducing last chance funding do so safely. We have various ideas how to, so call us first!

If the business is struggling it is probably insolvent or near insolvent. If so, the directors' duties begin to change from acting in the interests of shareholders to acting in the interests of creditors and to protect themselves they should record decisions, take and follow professional advice. Case law has established that following professional advice gives directors a high level of protection.

Raising fresh funding

In the current climate it can be difficult to raise finance to fund the turnaround of a distressed business. Often directors find they have to put money in personally or look to family and friends for funding. If you are considering doing this talk to us first – there are relatively safe ways of doing this where if the company was to fail you should be able to get your money back.

Before considering how to inject new funds or giving new or additional guarantees you should first estimate whether investment in the company is worthwhile. Is a better return achievable by closing the business and using the available funds for other investment opportunities? Or is it appropriate to use an insolvency procedure to restructure the business first?

At all costs avoid putting good money after bad. At the risk of stating the obviously it is important to get the basics right.

- Make sure you understand what has gone wrong and you know how to fix it.
- Prepare a business plan and financial forecasts – be realistic.
- Be smart if injecting rescue funding.
- Have a plan B.

If you decide to invest make sure that enough money is put in to fund trading until the company can be cashflow positive again and that you have a contingency plan if things do go wrong. There is little point in getting halfway through your planned turnaround only to run out of money and have to put the company into liquidation.

Other options for additional funding could include extended banking facilities with your current provider, business angel investors, specialist lenders, factors, bridge funders and finance brokers - providing cash when you need it most.

Read our briefing sheet for more detail on funding a distressed business

Negotiate with creditors

One of the greatest fears for directors is how creditors will respond to the news that they will not be paid on time or maybe not at all.

It may be that a company can be saved and creditors eventually paid in full if it is possible to buy some time. Having an Insolvency Practitioner involved early can be invaluable. They can deal with your creditors directly taking the heat off directors. In turn creditors can be reassured that the distressed business is receiving professional advice. If you cannot trade on and out without doing deals with creditors then you are going to have to enter into time to pay arrangements(“TTP”).

If a company cannot pay its debts as they fall due then it is insolvent. By doing a TTP a company can, through agreed extended terms, become solvent again.

In the Covid-19 era creditors and lenders are expected to be more receptive to rescheduling payments. In particular HMRC, whose debts can build up very quickly, is under political pressure to be lenient. HMRC is often open to any reasonable offer but informal TTPs with more than a few creditors are usually unworkable.

Company Voluntary Arrangements ("CVA")

CVAs were introduced in 1986 and got off to a slow start but with the decline in the high street and now Covid-19 most national retailers/casual diner businesses are either in or thinking about doing one as they can be used to walk away from unprofitable outlets and reduce rents.

A CVA allows directors of a company in financial difficulty to reach an agreement with its creditors regarding payment of its debts. The CVA process has to be carried out by a licensed insolvency practitioner but unlike administration and liquidation the directors remain in control.

The advantages of a CVA is that creditors cannot take action against the company during the CVA and once it has been completed the company has no liability to pre-CVA creditors. Although a CVA is not suitable for every company in financial distress it can allow the company to trade through its difficulties and give the directors more time to get their finances back on track without threat from creditors.

CVAs can be used if a company:

- Just needs time for something to happen (a contractual receipt/sell an asset/refinance/win litigation) to enable creditors to be paid in full or part.
- Wants to restructure and make voluntary contributions over a period of time (typically 5 years).
- Wants to wind down a business

To get the necessary 75% by value approval of creditors a CVA needs to offer something significantly better than administrations/liquidations – historically 30p to 40p in the pound compared to a few pence in liquidation … and with the reintroduction of Crown preference this will be much harder to achieve.

A word of warning, most CVAs fail – because most are based on voluntary contributions over 5 years that are too ambitious and more often than not things change …

For more information download our 'brief guide to CVAs'

Administration (including pre-packs)

If a CVA won't work then maybe an Administration could.

In 2003 administrations became main stream when banks could no longer appoint administrative receivers under new debentures. The major advantage over liquidation is that administration creates a moratorium stopping creditors from taking enforcement which can assist to sell a business and assets as a going concern.

Administration is a legal process designed to help struggling but potentially viable companies by protecting a business from its creditors whilst restructuring takes place. Ideally a company in administration can continue to trade through its difficulties and come out the other side as a going concern but more often than not it is used to achieve 'a better realisation of assets' or to facilitate a payment to preferential and secured creditors.

These days directors can choose their own administrator to work with rather than waiting for the bank or another creditor to impose one. Most administration appointments are made by the company's Board of Directors but a lender with a floating charge has a five day window to veto the Board's choice of IP and appoint their own choice.

Sounds good? Well unfortunately it comes at a high cost and is rarely affordable or suitable for smaller businesses. Also if a sale of the business as a going concern is on the cards then liquidation might be a better option as that avoids usually substantial TUPE liabilities (see "Liquidation" below for further details regarding TUPE).

For more information download our guide

Pre-pack administrations

An accelerated administration process that requires expert handling.

In 2003 no one had heard of pre-pack administrations but they quickly came to the fore and even today the majority of administrations are pre-packs. Over the years pre-packs got a bad name as cosy details behind closed doors and have become increasingly regulated so that today there has to be open marketing and detailed disclosure to creditors soon after the deal is done. Nevertheless pre-packs can be a useful tool to preserve value in a potentially viable business, help retain employment and provide a swift and better outcome for creditors. But the truth is that

Administrations are expensive and will only be suitable for most smaller businesses in specific circumstances.

Liquidation

If administration won't work then that leaves Liquidation.

Liquidations have been around since the introduction of limited liability companies in 1844. Used when a company has reached the end of the road.

An insolvent liquidation can be a Creditors' Voluntary Liquidation ("CVL") initiated by the directors and approved by the shareholders or a compulsory liquidation by a court order. The latter process takes 2 or 3 months before a liquidator is appointed, is quite costly and results in a civil servant known as the Official Receiver being appointed.

A creditors' voluntary liquidation effectively ends your responsibilities and uses the remaining assets of the company to pay off your creditors. Directors will always opt for CVL over a compulsory liquidation because it's quicker and they get to choose the insolvency practitioner. The assets are sold to the highest bidder – and that could be you – directors are legally permitted to buy back their business and assets in a CVL and part of the process of considering a CVL is helping directors explore that option.

A run of case law in Europe and the UK has determined that TUPE applies to all administration sales which transfers all employee liabilities to a purchaser (which can be significant) but does not apply to business and asset sales by a liquidator. For most insolvent small businesses, where employee liabilities can make or break a sale as a going concern, a CVL will likely be the best option and will potentially save employees jobs..

Download our guide to voluntary liquidations

Top 10 tips for worried directors

Our top 10 tips help company directors understand topical insolvency issues and avoid common pitfalls and difficulties.

1. **Know the financial position and have a plan (be realistic)** - exactly what information is required varies depending on the size and complexity of the business but at a minimum they should have up to date management accounts and be able to see that they have enough cashflow for the foreseeable future and if cashflow looks particularly tight prepare a 12 week rolling cashflow forecast. You should always have a realistic plan and always know where you want the business to go.
2. **Treat creditors equally** – once a business becomes insolvent the directors need to switch from working in shareholders' interests to working in creditors' interests.
3. **Seek professional advice early … and avoid misconduct issues/disqualification** – if the 12 week rolling or long term forecasts show the business is running out of money then you should seek professional advice early and follow that advice.
4. **Don't let Crown debt get >12 months in arrears** – whilst insolvency law requires that all creditors are treated equally the reality is that often HMRC get left behind. If your company is more than 12 months in arrears with its HMRC debts this is a red flag and could lead to directors' disqualification. Also, you should watch out for Joint Liability Notices for repeated offences where the Crown debt is greater than 50% [of the total amount of those companies' liabilities to their unsecured creditors].
5. **Have a written agreement or contract of employment** – and get paid through the payroll/PAYE scheme which helps to justify director claims for redundancy, pay in lieu of notice ("PILN") and arrears of wages which can easily amount to more than £15k.
6. **Stop drawing against Directors' Loan Account ("DLA")/paying dividends if no distributable reserves** – if the company has made losses since the last annual accounts then there may be no distributable reserves. If this is the case, or if you are unsure, it would be sensible to immediately stop drawing dividends and to draw a salary instead. Remember that interim dividends approved by the board of directors have no standing unless paid or posted in the accounting records. If you keep drawing dividends where there are no distributable reserves a liquidator may have to ask you to repay them.
7. **Pay market salary instead** – the case law is mixed but the general view is that it is OK for directors to pay themselves a fair market salary in place of dividends. Even if there is no cash to pay it can be posted and used to reduce any director's loan account.
8. **Be smart if injecting rescue funding** – rescue funding is always risky and directors/shareholders should be wary of this as they could end up as unsecured creditors.
9. **Have a plan B** – as that will speed up how quickly you can act if continuing to trade ceases to be an option. It also helps directors to understand their options and aids current and future decision making.
10. **Don't let it get you down** – the situation has gone too far if it does. This is a good test as to whether directors should take specialist advice. There almost certainly is a better way.