THE OSTRICH'S GUIDE TO BUSINESS SURVIVAL

Published by R3 (2002)

SECTION ONE

FAILURE AND RESCUE

Can **financial crisis** be averted? Are real business rescues possible? How can you help yourself and other people survive the tough times in business?

This booklet is divided into three sections. This, the first section, describes the **rescue culture** in Britain today. It looks at the facts behind business rescue and describes how a philosophy of enlightened self-interest can help you and the companies you do business with **overcome financial crisis.**

The second section helps you deal with **customers** whose financial problems could affect your own **financial health**. The third and last section aims to help you understand the steps you can take if **financial crisis** ever knocks on your company's door. We hope you never need it.

ABOUT THE BOOKLET

What's the Problem

In the five years from 1991, an average of 23,294 businesses failed every year. Our research shows that, if you have a customer that goes bust, you will be lucky to get back more than 10p in the pound on any outstanding debts.

How many bad debts like that could your business cope with, before it too became an insolvency statistic? And, if your business were to go bust, what would happen to you? Would you lose your job? Would your house go to pay the business's debts? Could you be forced into personal bankruptcy? Could your inaction lead to disqualification as a director? Might you find yourself facing fines or even prison? Worst of all – would your relationships with those near and dear to you survive the failure of your business?

Sadly, too many businesses fail because directors seem to believe it can never happen to them. It can – many businesses find themselves in an unexpected crisis. Hard choices may need to be made. But, if symptoms were recognised early enough, many more businesses would find themselves in the recovery ward – not the mortuary.

You may never face these problems. However, reading this booklet should ensure you recognise the signs of crisis, whether it affects your business or that of a client or supplier. We also hope that it will help you to act decisively and appropriately, should the need arise.

A NEW APPROACH

Be prepared

The majority of business insolvencies could have been prevented by early management action. In many cases, managers just do not have the information they need to recognise a crisis. The worst managers just ignore the warning signs. Thinking the unthinkable might just make the difference between weathering the storm and sinking without trace.

Who's insolvent?

Cash is king when it comes to avoiding insolvency. Companies are often plunged into failure because a creditor asks for money and cannot be paid. You may be on target to make a profit at the end of the year, but, if you cannot pay the tax man, the bank, or a big trade creditor when you should, you are insolvent and your business may be wound up.

Businesses whose asset base has been worn down over time are often more difficult to rescue than those that are merely strapped for cash.

It is not just current owings that determine whether you are technically insolvent. Liabilities that only normally arise if the company stops trading or goes bust are also taken into account. These include items lke redundancy payments and penalties for non-completion of contracts.

It's up to every director to be aware of the company's financial position and to take action if insolvency is likely. The legal penalties for failure to act can be harsh. Added to which, there is the waste of hard graft, hope and life that is bound up in every company failure.

Insolvency Definitions

A company is insolvent if:

- *it is unable to pay its debts when they fall due: the value of assets is less than the liabilities.*

Tight financial management, good communication with creditors and a willingness to ask for advice early would see far fewer businesses go to the wall.

What is The Rescue Culture?

Historically, British insolvency law and practice has always put the interests of creditors first. This objective is often compatible with business rescue: a 'going concern', revived or sold on, will almost always produce more for creditors than one that is closed down and whose assets are sold off at auction. R3 research into the 'intensive care' work done by licensed insolvency practitioners shows that an arrangement with creditors (or even a sale of a business as a going concern) is likely to produce more than a liquidation or fire sale.

Where informal rescues turn into formal insolvency, creditors get a great deal less than when rescue is achieved. In 59 per cent of formal insolvencies, returns of less than 10p in the pound were likely to be achieved. Returns of more than 50p in the pound were likely in only 9 per cent of cases. In rescues, the returns to creditors are considerably better: in 70 per cent of cases creditors got every penny they were due (even if they had to compromise and accept some jam tomorrow). Liability write-offs higher than 75 per cent (i.e. a return to creditors of less than 25 per cent), were reported in just one per cent of cases.

Rescues can only work where creditors are convinced they will get a larger return than would be achieved through insolvency. However, creditors must be prepared to compromise too.

Successful Rescues – The Ground Rules

- *consider supporting your customer, do not just turn off the lifeline of your orders to your customer if this means the source of their income (and thus your income) is restricted:*
- *be flexible with your debtors but don't extend your exposure or allow endless extensions of credit if they continue to default;*
- *renegotiate or pay your own suppliers on time;*
- *communicate with your bankers, suppliers and advisers, do not leave them in the dark;*
- *take advice from a licensed insolvency practitioner if a problem persists for your company or a customer.*

It is easy to place blame on the company in difficulty, but the rescue culture is based on us all having an active role in identifying and solving problems without destroying our own position. Licensed insolvency practitioners can assist – with or without the aid of formal insolvency procedures.

How Successful Is The Rescue Culture

In 1995-1996, insolvency practitioners rescued around 50 jobs for each member of the profession – about 98,000 in total. This, in a year when the economy was growing and business insolvencies had fallen far below recessionary levels.

Outside formal insolvencies, the intensive care process rescues many businesses and saves thousands of jobs, largely as a result of the banks' willingness to play an active part in allowing businesses to be reconstructed, rather than just cutting their losses. Contrary to the view of many business people, the banks are very reluctant to force businesses into insolvency and will be patient and constructive if they are kept informed and presented with a viable rescue plan.

However, companies still continue to fail in significant numbers. In 1995 – 96 companies were being liquidated at a rate of around 3,500 per quarter. This is a far cry from the dark days of the recession – in 1992 liquidations reached a peak of 6,200 in three months. Some of these were failures which no one could have prevented. But, management failure is a major contributory factor in the majority of all insolvencies.

CONTRARY TO THE VIEW OF MANY BUSINESS PEOPLE, THE BANKS ARE VERY RELUCTANT TO FORCE BUSINESSES INTO INSOLVENCY

Rescue Facts

- *98,000 jobs saved in 1995-6, 800,000 jobs saved between 1990-96:*
- *1600 – 1900 informal company rescues in 1996:*
- *Receiverships – 50 per cent rescued:*
- *CVAs – 75 per cent rescued.*

SECTION TWO

THE EFFECTIVE CREDITOR

When do you **get tough** with someone who owes you money? When should you believe the **hard luck stories** and help out?

This section aims to help you **deal with customers** whose financial crisis could hurt your business – perhaps fatally. You will find **practical steps** you can take to reduce the risk of a bad debt to the minimum.

This section also gives advice on dealing with the terminally ill customer and helps you make the choice between **tough and tender**. If the worst happens, and your customer **goes bust**, this section outlines your rights and how to exercise them.

A Surprisingly Common Story

The morning post includes a notice that a long-standing customer is insolvent, or a phone call chasing an overdue account is answered with details of the licensed insolvency practitioner who is now dealing with the company's affairs. This is the first you have heard of any problem!

Questions are asked immediately. Why did the salesman allow them further credit when the account was overdue? Why didn't the credit controller put the account on stop? Are we going to get any more money?

Answering these questions may help you learn from the experience. But, recriminations are useless – and you have passed the point where you can have any real influence on when and if you get paid.

Be careful you don't get the wrong answers too. If you ask what went wrong and get told the following (usually with a shrug of the shoulders) you can be sure your company has no real strategy for minimising bad debt problems:

- *In the commercial world failure is bound to happen.*
- *We take account of bad debts in our profit margins.*
- *We were just unlucky.*

Too few people really understand the implications of insolvency and the simple steps that can be taken to avoid some of the risks of other people's business failure.

WHEN YOU ARE OWED MONEY

MINIMISING THE IMPACT ON YOUR BUSINESS OF OTHER PEOPLE'S INSOLVENCY.

Other people's problems are your problem too. A bust customer who owes you money could mean the end of your business. A supplier you have failed to pay on time might cease trading – leaving you short of vital stock or services. To work, the rescue culture relies on business understanding that effective co-operation is as important a success factor as effective competition.

Bad Debt Prevention

Joining the rescue culture does not exclude protecting yourself: your business can be jeopardised if a customer fails. In a formal insolvency ordinary 'trade' or 'unsecured' creditors come last in a strict pecking order, after banks, the government, employees, HP/lease companies (sometimes) and landlords.

Returns to unsecured creditors in formal insolvencies are usually very low. So concentrating on making legal, ethical deals is likely to provide a better return for you – as long as you continue to believe that the company that owes you money can overcome its problems, with your support.

There are court processes to pursue intractable debtors including writs and winding up petitions. To pursue these to the end may lead to the liquidation of the debtor – so they may not be appropriate whilst some prospect of doing business with a supplier still exists. The value of court processes cannot be underestimated but they can take time and be costly. Some creditors, like the taxman, the VAT man, landlords and chargeholders (e.g. banks) can act more quickly and leave the unsecured creditor at the end of the queue. Unfortunately, if a company is in difficulties, drastic action may trigger the action of other creditors who are higher in the pecking order than you. So what can be done to protect your own position?

Communication

Even bad news is better than no news. The more informed you are, the more likely your actions will be realistic and successful. Talking and meeting with your customers will ensure you understand their problems and requirements and vice versa. An honest and open relationship with a trustworthy customer cannot be underestimated. But, make sure all the appropriate people in your company know what is going on too – and that you make your decisions based on complete knowledge of your own company's current financial situation and prospects.

Credit Control

A clear credit control procedure should be in place which sets out the system for dealing with overdue accounts. This should help identify problem customers. Do not extend customers' limits without due consideration and discussions. Try to stick to this no matter how well you think you know the customer.

Credit Checks

Check potential customers' credit references before giving them a credit account and regularly review credit limits. A company having difficulties may get by on smaller deliveries, made and paid for on a just-in-time basis. For larger customers whose payment period suddenly lengthens, why not consider visiting to review their accounts and projections – are they as 'blue chip' as they look?

Contract Terms

If your products are suitable, you may be able to include retention of title clauses (RoT) in your terms of trading. These enable stocks of your product to be repossessed from a customer in the event of non-payment, provided they can be identified and that they have not become an integral part of the customer's product. For example, a brick supplier may be able to repossess his bricks – but not if they have been cemented into a wall.

Is Your Customer in Danger?

these are just some of the warning signs which may mean your customer is facing financial crisis:

- *late payments or non-payment of invoices:*
- *lump-sum payments on account:*
- *payments by post-dated cheques;*
- *old invoices cleared only on receipt of new deliveries;*
- *using disputes to delay payment*

- *ACTION: Where any one of these factors is present – talk to your customer and consider reducing your exposure.*

Whether or not you have RoT clauses in your business conditions, do not assume you can just go along and pick up your products – it is not a presumption in law that unpaid goods belong to the supplier. Seek professional advice in any event.

Credit Insurance

It may be possible to obtain insurance against a customer's failure to pay. In addition, if you are factoring your invoices, or invoice discounting, a non-recourse arrangement will cost more – but it will mean you get paid a known proportion of every invoice.

Guarantees

Guarantees from directors or other group companies are sometimes available. There may be circumstances where they are appropriate so their potential should not be ignored. Apart from providing additional security they can help focus the debtors' minds in their obligations!

Know your rights; protect yourself – but plan your strategy carefully. All businesses will have problem customers and should have a strategy to deal with them. Customers who appreciate you have sound credit control procedures are likely to respect them. Those that don't – and who refuse to communicate with you – are the candidates for drastic action.

- *KNOW YOUR RIGHTS; PROTECT YOURSELF – BUT PLAN YOUR STRATEGY CAREFULLY. ALL BUSINESSES WILL HAVE PROBLEM CUSTOMERS AND SHOULD HAVE A STRATEGY TO DEAL WITH THEM.*

THE ENLIGHTENED CREDITOR

Dealing With Customers in Difficulties Or In Insolvency

So, you have done everything you can to protect yourself. You have taken every reasonable step to ensure you are doing business with people who can and will pay. But, things still look shaky – what can you do? Should help be offered or a tough approach taken?

The Critically Ill Customer

This will depend upon your customer and the impact your actions may have on your own business. Aggressive action by you made lead to the downfall of a valued customer. However, this is one area where you must lead with the head, not the heart: too many businesses have found themselves critically injured because they continued to extend credit for the sake of a friendly relationship with a long established customer.

The Customer in Formal Insolvency

It may seem ludicrous to supply a company that is in a formal insolvency procedure – especially if monies are already due to you.

In an administration or administrative receivership, when trading continues, payment is not guaranteed. However, the administrator or administrative receiver is acting as the insolvent company's agent and he should ensure that any creditors incurred by the company with his authority are paid – even before his fees.

This normally is enough guarantee for a supplier to make further supplies!

In a company voluntary arrangement (CVA – see below) or in an informal arrangement, terms of supply are normally strict, but will usually include some credit period. The arrangement will usually fail if the company does not stick to its supply terms. As this would almost certainly mean the end of the road for the company, this is a strong incentive to pay on time. There is always scope for terms to be altered as time passes.

An insolvent company that is unable to gain any supplies will not survive. There is less chance of an enhanced realisation value for the assets through either continued trading or a successful sale of the business – so, failure to supply could mean an even smaller return on the debts the company owed to you at the point of insolvency. Continuing to supply, after carefully considering whether you will be paid for future deliveries, could increase the chances of a better return on a bad debt and might provide future trade from an otherwise defunct customer.

Yours Rights as a Creditor

The best way to protect your rights as a creditor is to take an active role in the case. There is obviously commercial judgement involved as to whether time and effort spent chasing old debt is worth more than the same time spent prospecting for new business. Attending, or being represented at the initial creditors' meeting, will help you to make that judgement.

Sometimes, prospects of a reasonable return exist, but considerable effort may be required by the licensed insolvency practitioners to realise that return. It is particularly in these cases that an active creditors' committee can do much to ensure that good money is not spent chasing bad. Sadly, few creditors take up the challenge of representing their peers on creditors' committees. Were more to do so, there would certainly be less ignorance of what happens to insolvent companies and, given the specialist market and industry knowledge creditors are able to bring to bear, there would probably also be better and earlier returns for all.

Tough or Tender?

Use this checklist to help decide whether to support a customer in trouble:

- *is the customer trustworthy?*
- *are the customer's problems short term of long term, resolvable or terminal?*
- *do I need to maintain business from this customer?*
- *is my continued support critical to my customer's business?*
- *are there contractual reasons for me to continue supplying?*
- *can I help and cut my exposure over time?*
- *what is the downside if the customer fails?*
- *is my customer being professionally guided?*
- *What are my rights?*

- *ACTION: keep the answers to these questions under review until you are certain your customer's crisis has passed. If you cannot answer these questions for yourself, you should take professional advice.*

The committee of creditors is entitled to detailed information about the cost of liquidations, administrations, voluntary arrangements and bankruptcies, under Statement of Insolvency Practice 9 (SIP9), published by the Society of Practitioners of Insolvency (SPI).

SIP9 ensures that those charged with agreeing insolvency costs (generally the creditors' committee) have the information they need, including details of time spent, work done, expenses incurred, monies recovered and distributions made to creditors.

Licensed insolvency practitioners must provide creditors' guides explaining how fees and costs are charged and what creditors should do if dissatisfied.

This information should be made available to every identifiable creditor before any resolution is passed to fix or approve a licensed insolvency practitioner's remuneration.

Finally, licensed insolvency practitioners acting as receivers of companies are required on behalf of unsecured creditors to provide the liquidators, who will eventually replace them, with reasonable justification of the fees they have charged.

- ***CONSIDERABLE EFFORT MAY BE REQUIRED BY THE LICENSED INSOLVENCY PRACTITIONER TO REALISE THAT RETURN***

SECTION THREE

SURVIVING A CRISIS

What could be the **personal consequences** of your company's insolvency? How do you preserve your relationship with the **bank manager** when the money isn't coming in?

This section will help you **recognise the signs** of financial crisis in time to ensure rescue is more of a possibility than burial. It will help you understand your lender's point of view and outlines the kind of **rescue** options that may be open to you.

Finally, it helps you determine **who to turn to** for advice and outlines how you can complain effectively if you deal with a **licensed insolvency practitioner** and your case is badly handled.

YOUR RIGHTS AND RESPONSIBILITIES AS A DIRECTOR OR OWNER OF A BUSINESS IN CRISIS

It's Always Your Problem

As a director, the law says it is up to you to keep a finger on your company's pulse and to call for help if necessary. Directors of limited liability companies are personally liable for the debts of a company if trading continues after there is no longer any reasonable prospect of avoiding insolvency.

Since 1986, the Company Directors' Disqualification Act has raised the spectre of disqualification for directors who do not take their responsibilities seriously. This is no idle threat. 1767 directors were disqualified in the two years up to 1997. Most were disqualified for periods of between two and five years but nearly 30 per cent were banned for more than six and up to 15 years.

Company failure does not automatically lead to being disqualified as a director, to being criminally charged or to the enforcement of personal liability. The likelihood is still that the vast majority of the unaware or incompetent will not be penalised while resources are concentrated on cases where other, more serious offences appear to have been committed.

A lawyer will tell you that your potential liabilities may arise due to either wrongful trading, fraudulent trading, preferences, transactions at an undervalue or misfeasance. As a director you may have considered your actions were justified at the time and you may be able to defend that position.

However, the responsible director should not ignore the problems until either they go away or the company is forced into liquidation. The other extreme, that of ceasing to trade as soon as problems appear may seem low risk – but is hardly going to appeal to the determined, but struggling entrepreneur. Fortunately, as this booklet shows, there are other options.

Do not forget that you may be personally liable for some debts. Personal liability can often occur when personal guarantees have been given by directors either solely or jointly. Bank borrowings, leases on properties and HP/lease agreements often require personal guarantees. Sometimes, a personal guarantee is the only way that a creditor will supply goods. It is not uncommon for a director to have forgotten that these guarantees exist, only for them to re-emerge – as a rude shock – post insolvency. Their effect can be shattering: more than one in six of 1996's personal insolvencies were caused by personal guarantee liabilities.

These responsibilities apply to all directors – not just those with a stake in the business. And, it's no excuse if you are 'just the sales/manufacturing/personnel director': all directors have a legal responsibility to be aware of their business's financial position.

However, for business owners, it is even more important to keep one eye always on the business's financial health – financial failure means losing your investment. For those with personal guarantees, it could even mean losing your home. For some, the prospect of personal bankruptcy could be looming.

- ***DO NOT FORGET THAT YOU MAY BE PERSONALLY LIABLE FOR SOME DEBTS. PERSONAL LIABILITY CAN OFTEN OCCUR WHEN PERSONAL GUARANTEES HAVE BEEN GIVEN BY DIRECTORS EITHER SOLELY OR JOINTLY.***

The difficulties facing directors and business owners need not be faced alone. Financiers and trade creditors are often willing to assist and government creditors (e.g. Inland Revenue & Customs and Excise) are not always totally uncompromising. Advisors, such as lawyers and accountants, also have a vital role to play, especially when a director's actions can lead to personal liability.

If you think your company could be heading towards insolvency, seek early, professional advice, both on your responsibilities as a director and on your personal position.

The success of any rescue attempt is dependent upon early identification of the problems. It requires honesty and openness from everyone involved and it requires a commitment to enlightened self-interest.

RECOGNISING AND DEALING WITH A FINANCIAL CRISIS IN YOUR OWN COMPANY

A recent survey by R3 indicated the following main causes of company failure:

loss of market	29%
management failure	22%
bad debts	10%
lack of working capital	20%

Bad debt is, at least in part, a problem that is solved by effective credit control. Well-run businesses find it relatively easy to obtain capital. Therefore, it is probably reasonable that greater management acumen could help prevent nearly two thirds of failures.

A director of an insolvent company might be liable for:

- *issuing cheques when it is clear they will never be honoured*
- *incurring credit when there is little or no prospect of payment:*
- *taking customer deposits when goods or services will not be supplied;*
- *returning goods to a creditor when the creditor has not retained title;*
- *selling goods at less than their true open market value.*

- *ACTION: make sure you know your company's financial position. Take professional advice. If you are unsure where you stand see a licensed insolvency practitioner.*

Recognising a Problem

Any business can have a financial crisis: no business is immune from the impact of recession. Survivors, however, know where they are and know where they are going. They have a clear idea of the problems they face and they have plans to deal with them. They know the market never stands still and they constantly strive to improve the product or service they offer.

IF YOU ARE NOT SURE WHETHER YOUR COMPANY IS A SURVIVOR OR NOT, ASK THE FOLLOWING QUESTIONS:

Do you have a current business plan?

Do you review costs and overheads as well as sales?

Was your last set of audited accounts more than 12 months ago?

Do you prepare regular management accounts?

Do you prepare annual projections and cashflow forecasts?

Is actual performance regularly reviewed against plan?

Do you prepare and use aged debtor and creditor lists?

Do you and your co-directors meet regularly to formally review progress? Or, if you are on your own, do you set aside time just to understand your financial position?

THE KEYS TO AVOIDING FAILURE

- *be aware of your business's weaknesses and problems;*
- *be aware of the general business and economic environment;*
- *take action when there may be a problem, do not wait until the problem has occurred.*

IF YOU ARE DOING ALL THESE THINGS, THEN YOU ARE LIKELY TO BE IN A POSITION TO NOTICE THE SIGNS OF IMPENDING CRISIS. IF THEY OCCUR. YOU'LL KNOW YOU ARE STANDING AT THE TOP OF A SLIPPERY SLOPE IF YOUR PROCEDURES REVEAL THE FOLLOWING:

If any of the above makes you feel uncomfortable, try the list below. If any of these statements are true, chances are you are over the edge of the slope and heading downhill. It's time to seek help if any of these statements apply.

Poor collection of debtor book (greater than 45 days is considered poor in many business sectors).

Extended lines of credit – is exposure to key customers worsening?

Rising work in progress that is not billed on time.

Diminished cash balances – is the bank balance steadily reducing; are planned purchases being put off or are they being made by expanding payment periods, rather than cash?

Over reached overdraft facilities.

Poor cost control with too many people responsible for purchasing, leading to lack of organised discount opportunities.

Lack of long standing relationships with suppliers: Are you giving up on them – or are they giving up on you? Or are you widening your range of suppliers simply to make more credit available?

Rising stock levels and static sales

- *FOUR PER CENT OF CASES WERE CAUSED BY THE BANK SAYING 'ENOUGH IS ENOUGH'. RESEARCH INDICATES THAT 76 PER CENT OF INTENSIVE CARE CASES ARE STARTED BY THE BANK.*

Contract disputes

Final demands and writs being received

Your business is largely reliant on one or two customers – and those customers are not paying as well as they were.

You are increasing borrowings just to keep the business running.

Your outstanding debtors or potential bad debts seem to have increased suddenly.

Are you still unsure how much you owe, and how much you are owed?

You are more than one month adrift in payments to the Inland Revenue or the Customs and Excise.

The bank is calling you to say you have exceeded your overdraft limit.

You have received a statutory demand for payment, which could lead to a winding up petition.

If things have got this far, you should seek professional advice immediately.

Getting On With The Bank

In many cases, a company insolvency will be triggered by the company's bankers finally giving up all hope of seeing the business keep up with the terms of its facility. In nearly every case, this only happens after the bank has explored every other avenue – or when the bank completely loses confidence in the company. Company insolvency surveys show that only 4 per cent of cases are caused by the bank saying 'enough is enough'. Indeed, intensive care research indicates that 76 per cent of intensive care cases are started by the bank. In well over half (57 per cent) of these cases, a rescue is achieved outside insolvency. In a further 14 per cent of cases, an insolvency procedure (either administrative receivership or a Company Voluntary Arrangement) is used to achieve rescue.

Bank rescues usually start with the appointment of an investigating accountant (normally also a licensed insolvency practitioner). This figure is a bit of a bogeyman simply because, if insolvency is inevitable, he often is appointed as the administrative receiver. However, as we have shown, most bank investigations end in an informal rescue or reconstruction – not insolvency.

Part of the investigating accountant's doom-laden reputation must be due to the fact that, traditionally, his appointment is sudden and unexpected: if a company is communicating effectively with its banks, this is much less likely to be the case. The reasons for the appointment are more likely to be understood and the outcome is much more likely to be a good one for the business.

The British Bankers Association (BBA) has published a Statement of Principles 'Banks and Businesses: Working Together', codifying banks' policies concerning the treatment of companies in difficulties. It also shows what sort of information banks usually look for.

This makes it clear that the banks will support a realistic rescue proposal, as long as a client company communicates with them effectively and tries to keep to its commitments to the bank. You can get a free copy of the statement from the BBA by telephoning 020 7216 8846.

The Investigating Accountant's Report is often a starting point for the business's route to recovery and should be embraced by the directors, especially when they take into account their personal responsibilities. At a time of crisis professional help should be sought.

Remember, the report is not a foregone conclusion. It is an independent review.

Investigating Accountant Reports (or viability reports)

It's not only a bank that can ask a company to put in an investigating accountant. Occasionally larger trade creditors may do so.

When preparing the report, the investigating accountant relies upon the co-operation of a company's management- and one of the first things he will notice is whether the directors are truly on top of their financial situation or not, and whether they have a clear view of the future.

The investigating accountant's report is a review of the current position, a summary of future prospects and a recommendation of a way forward for a continued relationships between the company and its financier.

These confidential reports are intended to provide an objective view of the company. Although financial information is important (the report will normally provide an opinion on the viability of the company – or, perhaps, part of the company), these reports will usually include information about business trends in the company's marketplace.

The commissioning of the report is rarely the beginning of the end; more often than not it is the beginning of a way forward. In most cases (80 per cent, according to SPI research), this recommendation will not be the appointment of an administrative receiver.

Most directors find that such reports add value to their businesses and some may request a report to provide them with comfort that their company is neither insolvent nor that there is a problem looming on the horizon. Such formal 'health checks' are rare but may follow when a licensed insolvency practitioner's advice on the company is sought through a company's other advisers.

A RESCUE CAN BE ACHIEVED BY A NUMBER OF METHODS, DEPENDING ON THE PROBLEMS THAT NEED TO BE ADDRESSED.

Even if a report is initiated by a third party (and must meet that third party's needs), it is the target business that is paying for it: the directors should therefore ensure that the report is of benefit to their own company.

It is unlikely that a third party will commission such a report without good reason. However, sadly, a number of investigations are carried out each year simply because the directors have been unable (or unwilling) to come up with the financial information requested by their bank.

Often the report will make recommendations which may involve further monitoring of the position by the licensed insolvency practitioner to review the effectiveness of the proposals when enacted. Some of these recommendations may involve a voluntary or contractual arrangement.

Sometimes corrective action is necessary within the company. This might entail cutting costs, strengthening the management team, raising additional capital or selling the company or merging with a third party to provide the financial resources necessary to overcome the difficulties. Sometimes a formal insolvency procedure is recommended, but it will only be suggested if that is the appropriate way forward: that procedure itself can enable the rescue of a business.

Rescues

A rescue can be achieved by a number of methods, depending on the problems that need to be addressed and on the attitude of the company's creditors, particularly any secured creditor – such as the bank.

A company can negotiate with its lenders to reschedule debt or allow additional facilities. Banks will have an intensive care programme for these circumstances. This will often involve the use of a licensed insolvency practitioner to investigate the company's affairs. This investigation may lead to a report for the lender. As we have said, and contrary to popular belief, the end result of such a report more often than not leads to a rescue strategy without any formal insolvency.

Negotiations with government and trade creditors to reschedule payments. This aims to avoid action, like winding up petitions, which might force a company into insolvency. This involves communication with creditors, often assisted by a licensed insolvency practitioner acting as an intermediary to form an understanding (usually not binding to any party) between debtor and creditors. Using an intermediary often helps to ensure the debate remains objective and is not clouded by the emotional issues and hot tempers that often come to the fore in a crisis. The larger the number of creditors, the less likely that such an informal arrangement will work. Instead, a licensed insolvency practitioner may recommend a CVA which, once agreed, is binding on all parties.

The options outside formal insolvency are often put together with the assistance of a licensed insolvency practitioner acting on behalf of either debtors or creditors. Such options have no formal framework and are often unreported. If they became public knowledge, particularly in the case of quoted companies, then the company's ability to rescue itself would be instantly- and savagely- diminished.

Informal procedures will only work if the rescue culture attitude of 'enlightened self-interest' is adopted by the debtor and creditors involved. A licensed insolvency practitioner can assist in helping all parties to see the need for careful co-operation and by ensuring that everyone is satisfied that the proposed actions are within the law.

The End?

Sometimes a formal insolvency is unavoidable. But, this does not automatically mean a rescue is impossible. Once a business is in any form of formal insolvency procedure, the licensed insolvency practitioner's first responsibility is to the company's creditors. However, as we have pointed out, rescue (in whole or in part) is still likely to be the best possible option for creditors as well as for the business. The options in each form of insolvency can be summarised as follows.

Liquidations

Liquidations are not normally rescue procedures. The liquidator only has a limited power to continue the trade of a company. Therefore, a going concern sale of the business is uncommon- although possible if done almost immediately. The liquidator can sell the assets piecemeal to enable a new business to be established speedily, and this can include the sale of the name if it has value.

CVA'S ARE NEVER AN EASY OPTION FOR THE COMPANY, AS THE CREDITORS ARE UNLIKELY TO AGREE TO ANYTHING THAT DOES NOT OFFER SUBSTANTIALLY BETTER TERMS THAN A LESS RESCUE-ORIENTATED INSOLVENCY PROCEDURE.

Administrative Receivership

Normally, the administrative receiver has all the powers he needs to decide whether to continue to trade the company and attempt to achieve a going concern sale. Around half of all administrative receiverships end in rescue of all or part of the business. In many cases the business is sold back, free of debt, to its existing managers. So, receivership need not necessarily mean the end of a director's connection with a business – management buyouts are often the best solution for all concerned, including the creditors. Most administrative receivers are appointed as agents of the company and can exercise contracts on behalf of the company. The administrative receiver has wide powers to sell the assets and goodwill of the business but it is usual that the liabilities will remain with the company to be settled from the proceeds of sale.

Company Voluntary Arrangement (CVA)

In a CVA, proposals are drawn up which may involve delayed or reduced payments of debt, capital restructuring and an orderly realisation of assets. Creditors must usually agree to accept less than they are owed and, usually, to be repaid over a longer period of time. CVAs are never an easy option for the company, as creditors are unlikely to agree to anything that does not offer substantially better terms than a less rescue–orientated insolvency procedure. A meeting will be held to present the directors' proposals to creditors, 75 per cent (by value) of creditors present or by proxy must vote in favour of the arrangement for it to be binding on all parties. The arrangement is supervised by a licensed insolvency practitioner who, in many cases, will have advised the directors on the structure of the arrangement. However, on successful completion of the CVA the company's legal entity will remain substantially unaltered and the directors will be free to grow the business in whatever way they choose. Putting a CVA in place, however, does not necessarily tie the directors to the company: it can provide a vehicle to sell a business to new management too.

Administration

An administration order is an order of the court and an administrator is an officer of the court with similar powers to an administrative receiver. An administration order will only be granted if one or more of the following is possible: survival of the business (or part of it); better realisations than from a winding up; a CVA or arrangement with creditors that the court is satisfied has a realistic prospect of success.

Other Procedures

Schemes of Arrangements and Members' Voluntary Liquidations can also be used to ensure the survival of part of the business. Within the context of a rescue these procedures are usually only used in specific circumstances – for example, schemes of arrangement are often used as an alternative to liquidation for insurance companies.

WHO CAN HELP?

Getting Professional Advice from The Right Source

Your existing accountant, auditor or solicitor may be in a position to provide you with the advice you need. The provision of advice on insolvency matters invariably requires involvement of licensed insolvency practitioners and it is important to ensure that your existing advisors have this expertise (if formal insolvency is inevitable, your existing advisors will not be able to help, but may be able to point you in the right direction). If existing advisors cannot help, you are best advised to contact a licensed insolvency practitioner. Most, if not all, will offer you an initial free consultation. And, if your concern is not with your own insolvency but with that of a customer, a licensed insolvency practitioner will, in many cases, represent you free of charge at any creditors' meeting. Details of licensed insolvency practitioners close to you can be found in R3's annual directory.

Any Port in A Storm?

Reading this booklet means you are unlikely to be one of the many directors who, every year, are duped into taking advice from unregulated advisors who claim to be able to remove all the worry of insolvency. You will be fully aware of your company's financial position, you will talk to your bankers and you will take advice from professionals before it is too late. If crisis is inevitable, you will be prepared to make the right move towards the best possible resolution.

The unregulated advisor's typical victims are usually those who, having seen financial crisis creeping up on them, month after month, do nothing even when county court judgements and winding up petitions start piling up. Then, seemingly out of the blue, a letter will appear from a company offering salvation.

Whilst there are some genuine, skilled and professional company doctors who operate this way, the best that is likely is that the directors are charged a fee for the advice that they consult an insolvency practitioner. The worst is that the directors may be promised the moon, charged the earth and see nothing for it – they certainly won't escape their creditors.

Only licensed insolvency practitioners can take formal insolvency appointments (other than Law of Property Act (LPA) receiverships, which are only used to take control of mortgaged property). They also have enormous experience in the arena of informal rescue and reconstruction.

It is true that many people could advise and assist you with informal reconstructions. You do not necessarily need to deal with a licensed insolvency practitioner. Our advice, however, is to ensure you deal with a regulated professional (such as an accountant, solicitor or even, in the case of property-related insolvencies, a chartered surveyor) whose code of ethics and discipline will ensure they deal fairly with your interests and those of your creditors. At the very worst, if things go badly wrong, you will be able to complain to their regulatory body and have the satisfaction of seeing action taken against them if your complaint is justified. Deal with an unregulated advisor and you have no guarantees or propriety, knowledge or skills.

Complaining Effectively

If you have a complaint about the way in which a licensed insolvency practitioner has dealt with your case, you should, in the first instance contact the practitioner concerned: most complaints are based on misunderstandings. If you are still dissatisfied, you should contact the practitioner's recognised professional body (RPB). If you are unsure of this, contact the Association of Business Recovery Professionals (R3), who will be pleased to point you in the right direction.

Your complaint will be greatly assisted if you keep accurate notes of your experience during the case (make them at the time – not later) as well as copies of all correspondence received. It is as well to confirm critical details in writing.

Insolvency law and practice is a hugely complicated area, further complicated by the fact that a business crisis is normally an intensely stressful experience for everyone involved. Complaints are rare (567) complaints against 18,297 insolvency cases in 1995) and most turn out to be misunderstandings. But, they are always investigated and, if necessary, dealt with by the disciplinary procedures of the practitioner's licensing body who can reprimand, levy fines and even take away a person's license. In 1995, the RPBs received 567 complaints. Of these, 534 merited further investigation and 56 led to full disciplinary hearings. As a result of this 51 practitioners were fined and 10 lost their licence.

DEAL WITH A REGULATED PROFESSIONAL (SUCH AS AN ACCOUNTANT, SOLICITOR OR EVEN, IN THE CASE OF PROPERTY-RELATED INSOLVENCIES, A CHARTERED SURVEYOR) WHOSE CODE OF ETHICS AND DISCIPLINE WILL ENSURE THEY DEAL FAIRLY WITH YOUR INTERESTS AND THOSE OF YOUR CREDITORS.

The insolvency profession is proud of its reputation and anxious to ensure that all poor practice or, worse, malpractice, is eliminated.

About The Insolvency Profession

The insolvency profession consists of fewer than 2000 individuals who are authorised to undertake or supervise company and personal insolvencies. These licensed insolvency practitioners are all authorised by one of eight recognised professional bodies (RPB), or by the Secretary of State for Trade and Industry.

Because licensed insolvency practitioners come from a wide range of professional backgrounds they are usually licensed by the body from whom they obtained their first professional qualification. Any practitioner joining the profession since 1986 has undertaken around three years further specialised training and has had to pass the examination of the Joint Insolvency Examination Board (JIEB) before he or she can be licensed.

All insolvency practitioners are subject to the same rules regarding their conduct. They have a common ethical code and the same set of rules concerning the information they must provide to creditors. Their work is also subject to regular scrutiny and monitoring.

WE ESTIMATE THAT, IN 1995 – 1996, LICENSED INSOLVENCY PRACITIONERS RESCUED COMPANIES WITH A TOTAL TURNOVER OF £23 BILLION AND SAVED 98,000 JOBS. WE HOPE YOUR BUSINESS WILL NEVER NEED OUR SERVICES. BUT, IF IT DOES, HAVING READ THIS BOOKLET WILL HELP YOU ENSURE THAT YOUR BUSINESS IS ONE OF THE 'SAVED'- RATHER THAN ONE OF THE 'BURIED'.