Crunch time

When business gets tough, you may be wondering whether to stay, sell or call it a day. Insolvency and business rescue expert Steve Foster considers the options

The last year has brought dramatic changes to the business landscape, the likes of which have not been experienced for generations. The challenge for many in the property sector is deciding what to do in the current climate.

Is now perhaps a good time to sell and get out? Should you look instead to buying or merging with another company? Or are things really so bad that calling it a day seems to be the only viable option?

In this article, I will talk through some of the options for property professionals and offers some tips on how to get as much out of the situation as you can.

A time for important decisions

Many property professionals tell us they have reached a cross-road for their business and its long-term health. Times are difficult and the decisions many are facing are tough. They are ones that will affect both their business and personal life. As a result, it is crucial that the decisions you currently take are well-informed. As part of your decision-making process, this means having:

- Access to up to date and accurate financial information on your businesses performance
- A clear understanding of the key features which drive it, including the causes of any underperformance and the longer term keys to success
- An understanding of all the options open to you – perhaps from taking professional advice to gain ideas and an objective view of your circumstances
- An appreciation of the impact that the various options will have on third parties connected to your business

Keeping the business going – obtaining a financial injection

You may have already experienced that obtaining bank funding at the moment can be quite difficult. Property professionals are not alone in finding that if a bank loan or extension to the overdraft is available, the arrangement fees and interest rate margins may be higher than in the past. These charges reflect the risk the bank perceives it is taking, and I'm afraid the sector as a whole has lost its favoured status with some of the banks.

If you do need finance, the Government's new Enterprise Finance Guarantee Scheme for small and medium sized businesses may help.

In essence, the Government guarantees up to 75% of lending to viable businesses to ensure that they can get the working capital and investment they need. It is open to UK businesses with a turnover of up to £25 million.

There are criteria you'll need to satisfy and so contact your bank manager, accountant or The Department for Business Enterprise and Regulatory Reform for more information.

If you are thinking of attracting an investor to your business, then be prepared that, in return for a financial injection, they are likely to insist on taking an active role in your business as well as becoming a part owner.

They will also want a clear path for a return on their investment (probably sooner rather than later). Their participation (in terms of their day to day involvement, their equity stake or profit share and the way this is to be achieved) needs to be clarified in advance.

So should I sell?

The decision to sell is always a difficult one. The process can be extremely complex and contains many traps for the unwary property professional. The more you can plan the components of the sale, the greater your chance of securing a good price and best possible terms. At the same time, it's wise to be

clear about your motives as these will influence the sale (and your satisfaction with it – or not).

Motives differ: for example, is the income from the sale your key driver in this decision? Would you prefer shares in the ongoing business? Perhaps you want a continued involvement in the business – you may not want to sell the whole of the business, but instead a part of it?

Do you want to sell the business to the existing management team, so that you no longer have to worry about the personal guarantees you've made to the bank?

Perhaps the business has a requirement for cash, which you are unwilling or unable to fund?

Whatever your motives, it is important to discuss them with your business advisers otherwise the sale is unlikely to bring the result you want. And if you are looking to fund a sale, what options are currently open to you?

Business valuations in the sector are presently at a low, as the shortage of buyers has been exacerbated by the banks' caution in financing business purchases.

A number of sales are being part-funded by raising cash through invoice discounting and by conducting share swaps. If you want to sell your business, then consider alternative means of funding and payment. As well as flexibility, it also pays to have realistic expectations in what you are prepared to take for your business in order to be able to walk away.

What about merging?

If you would prefer to merge with a company and take a reduced stake in a bigger organisation, my advice is not to skimp on the due diligence even if the deal may look very attractive initially. It is important to be very clear about the financial position the other party are in. Is it worse than yours? How 'fair' is the share you are likely to gain in relation to what your business brings to the table and its strengths?

Getting your business into shape

Whether you decide to attract outside investors, go to the bank for additional funding, merge or sell a part or the whole of the business, you will want the business to be in as good a shape as you can get it.

This will maximise the value you get and may also make the difference between success and failure. Here are some key areas you should consider tackling.

Monitoring performance

Review all your budgets and reset targets more realistically for the next 12 months. Decide on which key performance indicators you need to closely monitor to safeguard your business and achieve these targets (for example, new business leads generated and converted, your cash balance, number of debtor days, level of gross profit and/or net profit).

Also, review the efficiency of your current business operation and consider alternatives to improve it. If you have customers who are not paying, then consider parting ways or negotiating alternative terms which will bring in the fees – albeit over a longer period (perhaps with a premium for this special arrangement?).

Focus your efforts on making sure your relationships with your better customers and business referrers are solid.

Careful cash control

Now more than ever you need to review your debtors list frequently and chase up overdue invoices.

You might want to consider offering existing debtors extended payment terms and/or settlement discounts but either way, make sure your terms of business contain explicit payment terms and you demonstrate keeping to them.

On the supply side of things, try agreeing extended payment terms with all your suppliers in advance. And if you're managing a team, why not use 'bottom up' budgeting? This encourages everyone in the office to give input on areas over which they have some control – try targeting a 10% cost saving.

As part of your reviews, you will need to consider your staffing needs and costs over the next 12 months. Can people opt for a reduced working week until the economy improves?

Stronger measures

If business is looking bleak and you are worried about being able to continue trading, perhaps because:

- There is pressure from trade creditors or the bank
- The PAYE and VAT are in arrears
- Meeting the salaries bill at the end of the month will be a challenge.

In these circumstances, you will need specialist advice from an insolvency practitioner.

Do not stick your head in the sand. Remember that you need to keep as much control of the situation as you can to safeguard your own financial position. If you do no, you might find yourself under inquiry by the Department of Trade and Industry and explaining your actions to your professional body.

To avoid this, an insolvency practi-

MANAGEMENT MAKEOVER

Each business is unique but to help it achieve the options we've described above, it is important to tidy up some key issues such as:

- Rationalising your business structure – try and eliminate any complex structures and consider separating companies now that would not be part of a sale.
- Maximising your management capability – ensure adequate skills exist (even after you have gone). This may mean recruiting a suitable successor now.
- Formalising contracts – if you have any understandings or informal contracts currently in place, now's the time to ensure they are formalised so they can be relied upon and transferred to new owners if appropriate.
- Plumping up your profitability – the more profitable you are, the more attractive you'll be to a buyer. Look at reducing your non-business expenditure.
- Tidying up your balance sheet and improve your debt-recovery. Review the status and value of your property and other fixed assets.
- Reducing your dependency on key customers or suppliers as they can reduce the marketability of your business – especially if the relationships lie with you rather than the practice as a whole.

tioner will give you specialist advice on your circumstances. Here are some of the options they may propose.

Corporate voluntary arrangements (CVA) and Partnership voluntary arrangements (PVA)

These require the involvement of an insolvency practitioner but are not formal arrangements like an administration or liquidation. In the case of CVAs or PVAs, the business owners work with the insolvency specialist to establish the current position of the business.

They then make proposals to all the creditors. Typically, the business's creditors (the trade suppliers, customers who have pre-paid, the landlord, HM Revenue & Customs, etc) are asked to waive part of their debt to give the business time to pay.

There are no set rules, but a payment schedule is created and tailored to that business. For example, if it needs an initial period of low payments to get back onto an even footing, then this can be reflected in the offer to the creditors.

The key is to make proposals which are advantageous to all interested parties. It is no good offering 1p in the £1 payable over the next 10 years if the business can clearly afford much more and sooner. Such proposals will be rejected by the creditors.

Under this arrangement, all creditors are notified of the proposals and if 75% (in value) of those who vote are in favour, then the arrangement is binding on ALL creditors. Those not in favour, or who did not vote, cannot take court action. HMRC normally support proposals which, in the circumstances, are seen as reasonable.

Of course you will need to take account of those suppliers who will not get what they expect and may refuse or be reluctant to supply your business in the future.

They may impose stricter trading terms – payment in advance or on delivery, for example. Some creditors may introduce other options – for example, a landlord may not be able to chase for rent arrears but (because of the lease's terms) can throw you out!

CVAs and PVAs are not cheap but their cost can be small in relation to the debt written off, the prospect of personal liability (in the case of partners, who could lose private assets including their home) and the longer term value of the business.

If the business cannot make its promised payments, it can go back to the insolvency practitioner. They act rather like independent arbitrator and, if revised proposals are reasonable, then they can agree these. They do have to write to all creditors explaining why they make sense, though.

Going into administration

If a CVA or PVA is not appropriate then administrators may be appointed. The administrator can be appointed by the court (on an application from your creditors, you as directors/partners or your bank).

Once administrators are appointed, creditors cannot take any further action against the business. The administrator will do what they can to raise as much money as possible in order to repay them by focusing on:

- Selling the business as a going concern, or
- Achieving a better result for the creditors than would be likely if your business was wound up, or
- Sell the property of your business (customer list, desks, stock, etc) in order to pay in full or in part one or more of its secured or preferred creditors.

If, after the costs of the administration, all creditors are paid off in full, then any surplus will be returned to the shareholders.

Pre-pack administration

This has been under fire in the press recently following its use in a number of high street retailers. Under other forms of insolvency it can be difficult to keep the business going long enough to organise an orderly sale in the open market. Under the pre-pack route, a deal to sell the assets of the failed business is agreed prior to insolvency and is then completed immediately after the appointment of administrators.

The most common buyers of an insolvent company are its own

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directors or shareholders.

A 'phoenix' rises from the ashes of the old business and buys its assets. Criticism of these companies has suggested creditors lose out as the new business might operate from the same premises with a similar name and with some or all of the old directors.

It can look as if creditors have been out-manoeuvred. Some statistics, however, show that creditors tend to do better under pre-packs. Business and jobs are saved and many businesses do recover well from this route.

Liquidation – closing the business

If your business is liquidated, the liquidator will sell off anything saleable from your business to pay your creditors. Then, if there is anything left over, they will pay your shareholders. The business is then dissolved.

A limited company will be removed from the list held by the registrar of companies and will no longer exist. Of course some businesses are able to pay all of their debts and are merely liquidated by the shareholders because perhaps business has ceased, (rather than as a result of insolvency). This is known as a Members Voluntary Liquidation.

Consider the bigger picture

In practice, any change in the legal entity of your business can be expensive in terms of both cost and time. Furthermore, in any insolvency situation - whether CVA/PVA, administration or liquidation etc, somebody will almost inevitably lose out as the business can not pay all of its debts, the liabilities exceed its assets.

The person losing out could be you, your creditors, your suppliers, your customers or your staff. As a result, there are a number of factors which need careful consideration, when assessing the options I have described and these include:

- Your suppliers – Would they still supply you if your business entity changed? You would need to inform them. How important are you to their business? Pay particular thought to your landlord and the terms of your lease.
- Her Majesty's Revenue & Customs (HMRC) – if you owe VAT from an insolvent business, HMRC may ask for money in advance as security for future VAT due from your new business as a condition of registration. This hefty bill can be a real barrier and hard to pay as you try to start up again.
- Your customers – what ongoing agreements have you got with them that you will be defaulting on? What would undermining their confidence result in - either for your existing business (and in trying to sell it on) or in setting up a phoenix company? If you have contracts in place with them, you will need to let them know if your business entity changes.
- Your staff – what effect would the different options have on morale? If you are trying to sell the business as a going concern, what would damage could low morale do to your company's performance and ability to find a buyer? If you do sell the business on, your staff's employment rights may need to be transferred, and your buyer will assess your business's attractiveness in relation to these.
- Third parties - You should keep certain third parties closely informed. This might include some with whom you may not have a direct contractual relationship such as the tenants where you act on behalf of the landlord. These people can be adversely affected, especially if client accounts have not been properly maintained; as the tenant can end up in a dispute with the landlord over the return of their deposit.
- Your membership of organisations such as the NFoPP - One of NFoPP's key objectives is public protection and that protection applies to individual consumers of property services and to potential creditors of property businesses. For this reason insolvency, arrangements with creditors, and bankruptcy, can have implications for membership of any division of NFoPP. NFOPP says that members should advise the organisation's Compliance Department of any material change to the status of any property business which they either partially or wholly own, or which employs them. The NFOPP may consider disciplinary action if, after investigation, a member who is a Principal, Partner, or Director, is deemed to have failed to ensure that their personal and professional finances have been managed appropriately. The NFOPP's Compliance Department can be contacted on: 01926 417791.

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Summary

Every business is unique and one of the good things about this recession is that companies are more willing to discuss trading terms. If you have a good business and are struggling, there may be options open to you other than administration or liquidation. None of the options we've mentioned are a quick fix and each carries long-term implications for a business that can make trading difficult in the future (for example, banks may be reluctant to deal with phoenix companies).

The best way to find the right route to take in this recession is to gain specialist advice either from your accountant, NFOPP or a corporate recovery expert. ■

Steve Foster is a Principal at Shipleys LLP, where he advises clients ranging from ambitious start-ups to public companies. His wide ranging experience includes sectors such as property and he has considerable experience in business planning and strategy to help businesses achieve their objectives, whether to purchase, expand, enter new markets or formulate an effective exit strategy (including a sale). He is based at Shipleys LLP in Godalming, Surrey. Shipleys, whose other offices are in London, Birmingham, and Saffron Walden, provides a full range of accounting, taxation and business advisory services. www.shipleys.com