Business DISTRESS Index

Association of Business Recovery Professionals
R3
Rescue Recovery Renewal

One in ten businesses fear insolvency

Signs of distress are increasing among the business community

A quarter of businesses are experiencing cash flow difficulties

Welcome to the second wave of insolvency trade body R3's 'Business Distress Index' - a key quarterly barometer of the financial position of GB businesses. The second reading was taken in December 2010.

Over the course of the last quarter, more businesses have begun to experience key signs of distress, such as the loss of regular customers and cash flow difficulties. Since September 2010, businesses' concerns about their levels of debt has increased, the support of key creditors is seen to have diminished and perceived likelihood of insolvency now stands at around one in ten businesses.

Signs of distress:

- More businesses are experiencing key distress signs than they were in September 2010, with increases in the number of businesses seeing decreased profits (now over half of businesses, at 54% - up 5%), the loss of regular customers (standing at around a third at 32% - up 6%) and cash flow difficulties (around a quarter of businesses at 24% - up 5%).
- The most common signs of distress remain: decreased profits, a reduction in sales volume, the loss of regular customers and a fall in market share.
- Businesses in the North are more likely to be experiencing key distress signs than those based elsewhere, with 83% of business in the area experiencing at least one sign of distress. This compares to 78% in the Midlands and 71% in the South.
- Manufacturing businesses are more likely to be experiencing key distress signs, with 82% experiencing at least one sign of distress; which compares to 72% of those in the services sector and 80% in the retail and distribution sector.
- A greater number of small businesses tend to experience key signs of distress.

Debt concern:

- Concern about debt levels has increased among the business community over the last quarter, with more than one in four businesses saying they are concerned about their debts (25%).
- Of those businesses concerned about their debts, significant increases in concern over bank loans and other finance (a rise of 10%) and Crown debts (a rise of 16%) seems to account for an overall increase in debt worries.

Perceived creditor approach:

- Businesses perceive a slight fall in the support shown to them by HMRC and the banks over the last quarter; while trade creditors are seen to have become marginally more supportive during this period. Overall, businesses see HMRC as their most supportive creditor, followed closely by trade creditors, and closely again by the banks.
- Among the business community, questions about the attitude of the banks elicit some polarised responses. A growing proportion of businesses do not perceive the banks as supportive - in September, the proportion of businesses that did not believe the banks had been supportive stood at 22%; this has now risen to 31%. Overall, however, there are more businesses that believe banks have behaved supportively than those that take the opposite view.

Insolvency fears:

- Perceived likelihood of insolvency has increased over the last quarter, with almost one in ten businesses now believing they are at risk of insolvency (9%).

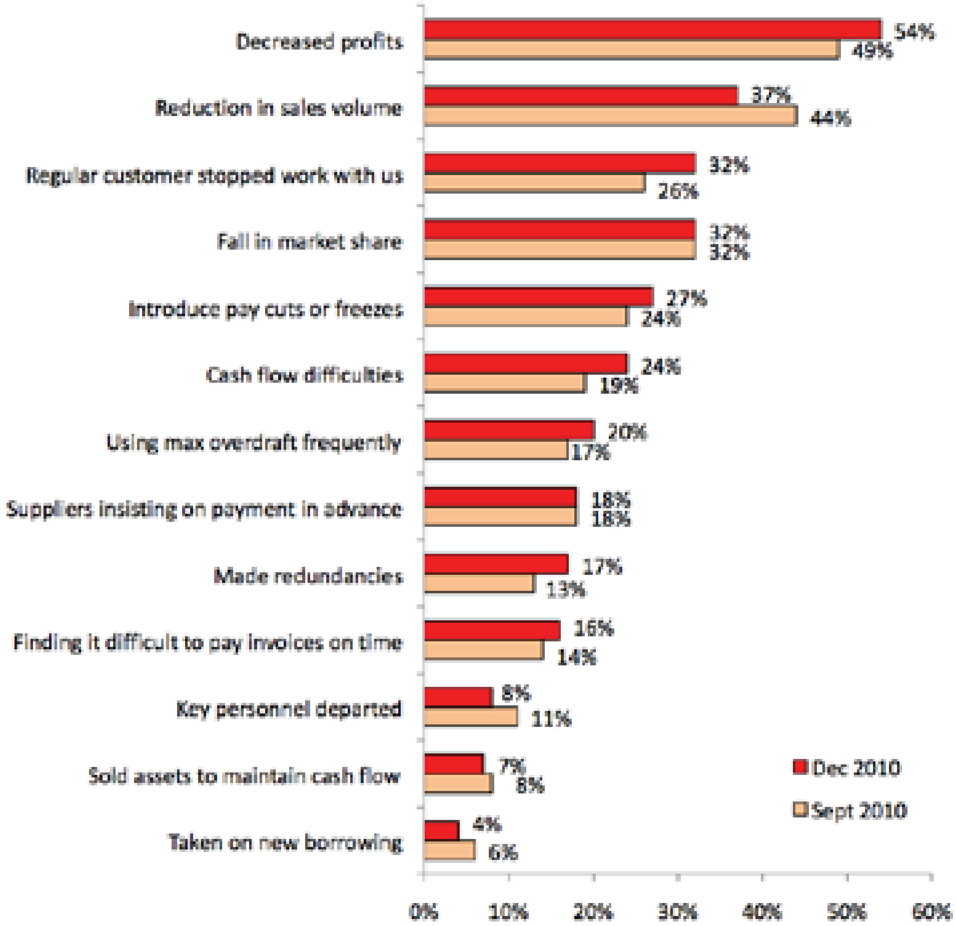
Signs of distress

R3 has identified key signs of business distress, using this survey as a way of identifying how many GB businesses have recently experienced each sign.

More businesses are experiencing key distress signs than they were in September 2010, with key increases in the number of businesses seeing decreased profits (54%), the loss of regular customers (32%) and cash flow difficulties (24%). The most common signs of distress remain decreased profits, a reduction in sales volume, the loss of regular customers and a fall in market share.

There has been a 4% jump in the number of businesses making redundancies and smaller increases (3%) in those introducing pay cuts/ freezes and using their maximum overdraft facility fairly frequently. This may reflect an effort to address cash flow difficulties as a consequence of lower profits.

Percentage of businesses experiencing each sign of distress:



R3 President Steven Law interprets the results:

"The overall picture suggests businesses are finding conditions more challenging than they were a few months ago. It is particularly concerning to see one in six businesses finding it hard to pay invoices on time given that an inability to pay bills when they fall due is the main definition of insolvency. As such, it is one of the critical warning signs of financial distress. Frequent use of the maximum overdraft facility is also a very negative state of affairs, currently experienced by one in five businesses. It indicates that the overdraft has become 'hardcore', with the normal pattern of business fluctuation lost. The banks will be monitoring for this kind of intelligence, and business in this position will start to ring their alarm bells.

"One of the few signs of distress to have declined since September 2010 is a reduction in sales volume. Given that the number of businesses experiencing decreased profits and cash flow difficulties has grown, this may indicate an increase in overheads and other outgoings rather than a decrease in demand. It also suggests that businesses may be selling a healthy volume but at a discounted price, which impacts directly on their gross margin and, ultimately, their bottom line.

"It is worth noting that this survey took place during bad weather conditions, which took their toll on certain sections of the business community, and may also have affected their overall outlook. The impact of the bad weather underlines the importance of ensuring that businesses have built up sufficient reserves to act as a 'buffer zone' in times of temporary difficulty."

Number of businesses experiencing each distress sign

R3 has extrapolated the figures to provide an indication of how many businesses are experiencing each distress sign:

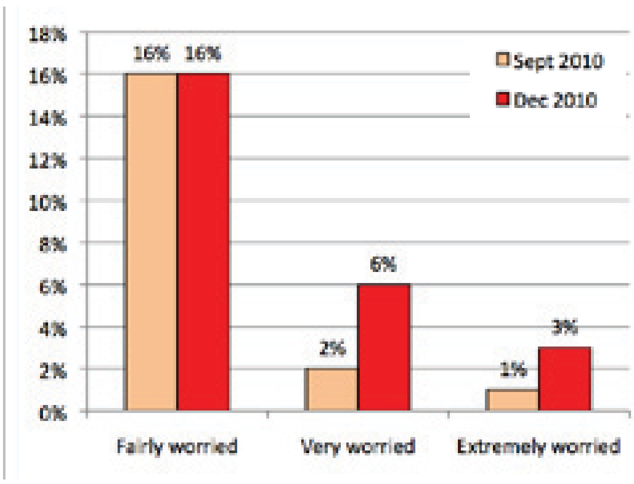
	Sept 2010	Dec 2010
Decreased profits	854,000	934,000
Reduction in sales volume	751,000	647,000
Fall in market share	548,000	553,000
Regular customer stopped work with us	451,000	557,000
Introduce pay cuts or freezes	419,000	473,000
Cash flow difficulties	321,000	414,000
Suppliers insisting on payment in advance	315,000	310,000
Using max overdraft frequently	293,000	350,000
Finding it difficult to pay invoices on time	240,000	268,000
Made redundancies	229,000	294,000
Key personnel departed	182,000	144,000
Sold assets to maintain cash flow	139,000	124,000
Taken on new borrowing	107,000	70,000

Concern about debt levels

Businesses were asked 'How concerned or otherwise are you about the current level of your debt in your business?'. They were asked to consider all of their debts, then the following debts specifically: finance, bank loans and hire purchase; Crown debts and VAT; and debts owed to trade creditors.

Concern about overall debt levels has increased among the business community over the last quarter, with one in four businesses saying they are concerned about their debts (25%). This compares to 19% in September 2010.

Percentage of businesses who are concerned about debts, to varying degrees:

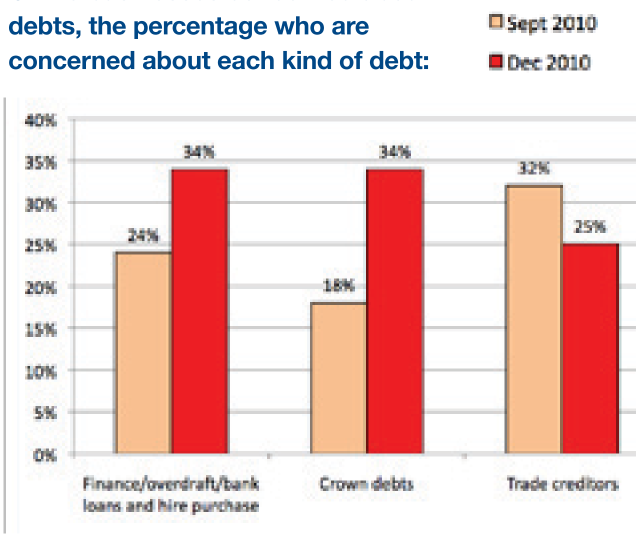


Concern about different kinds of debt

Of those businesses concerned about their debts, significant increases in concern over bank loans and other finance and Crown debts seems to account for the increase in overall debt worries.

Concern about bank loans and other finance has increased by 10% over the last quarter, and concern about Crown debts has jumped by 16% during this time. This is juxtaposed with a decline in concern about debts owed to trade creditors, where there has been a 7% decrease.

Of the businesses concerned about debts, the percentage who are concerned about each kind of debt:



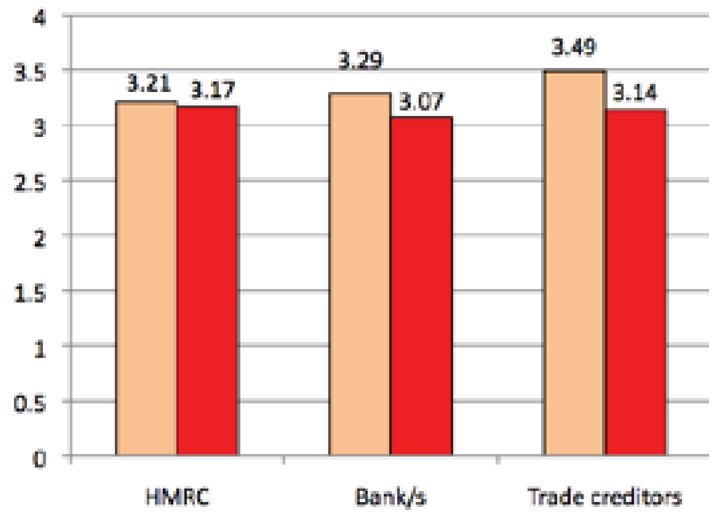
Attitudes of creditors over the last 3 months

Businesses were asked whether they agree or disagree with the following statements:

- 'The banks have been generally supportive over the last 3 months'
- 'Trade creditors have been broadly supportive in extending credit over the last 3 months'
- 'On the whole, HMRC has been supportive over the last 3 months'

Mean scores have been calculated by assigning numerical values to each response, where 'agree strongly' = 5, 'agree slightly' = 4, 'neither agree nor disagree' = 3, 'agree slightly' = 2 and 'disagree strongly' = 1.

Mean scores attributed to each creditor group (the higher the score = the more supportive):



Perhaps a reflection of debts owed to each creditor group and the associated concern about these debts, businesses perceive a very slight fall in the support shown to them by HMRC and the banks over the last quarter; while trade creditors are seen to have become marginally more supportive over the last three months. Overall, businesses see HMRC as their most supportive creditor, followed closely by trade creditors, and closely again by the banks.

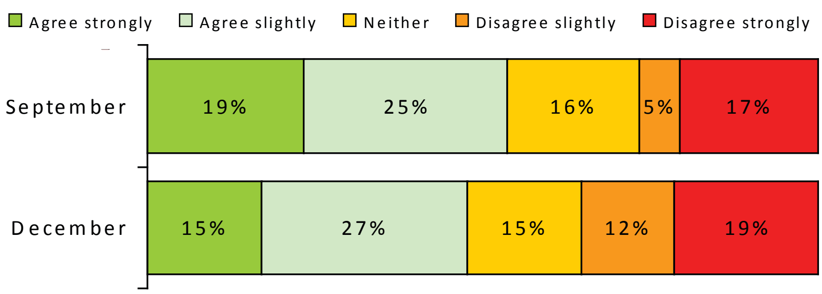
R3 President Steven Law interprets the results:

"The fact that businesses perceive HMRC as their most supportive creditor is likely to reflect the considerable success of the Revenue's Time to Pay scheme, widely credited with stemming the tide of insolvencies during the recession by giving businesses more time to pay certain tax debts. The marginal fall in perceived support in recent months may reflect a tightening up of Time to Pay directed towards 'zombie businesses' repeatedly deferring taxes and largely unable to service their debts."

Perceptions of bank support

Among the business community, questions about the attitude of the banks elicit some polarised responses. A growing proportion of businesses do not perceive the banks as supportive. In September, the proportion of businesses that did not believe that the banks had been supportive stood at 22%, this has now risen to 31% (taking 'disagree slightly' and 'disagree strongly' together in both cases).

Perception of the banks: The banks have been generally supportive over the last 3 months'



Overall, however, the results still show that more businesses believe banks have behaved supportively in recent times than hold the opposite view - 42% of businesses believe the banks have been supportive while 31% do not believe this has been the case.

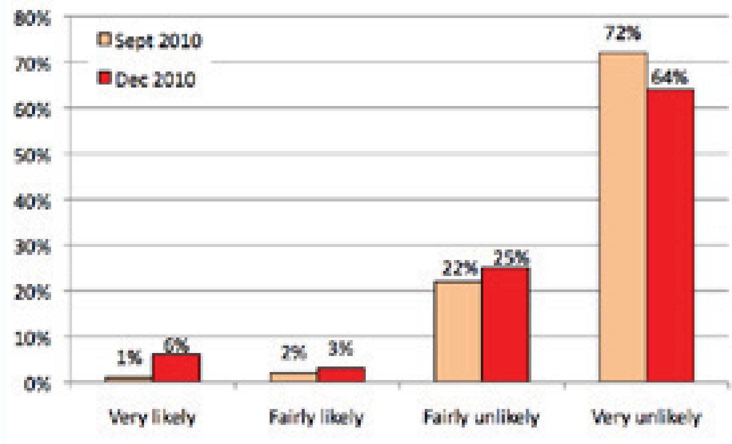
Likelihood of insolvency over the next 12 months

Businesses were asked 'Thinking about the coming 12 months, how likely or unlikely do you think your business is to go into insolvency?'.

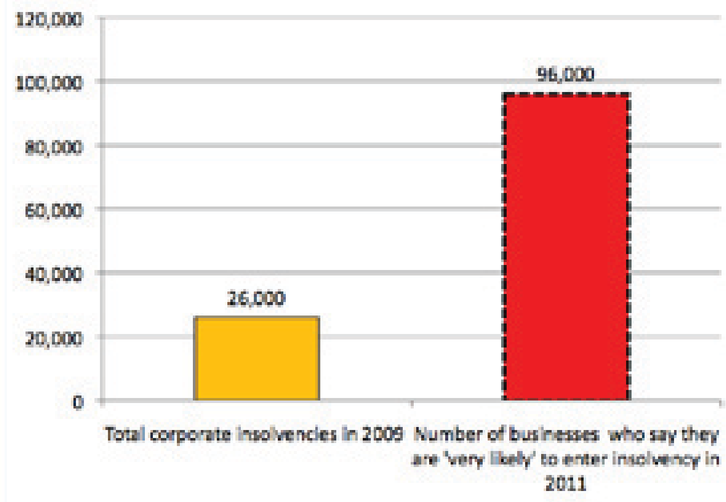
Perceived likelihood of insolvency has increased three fold over the last quarter - from 3% to 9%. Conversely, the proportion of businesses who say they are 'very unlikely' to go into insolvency over the next twelve months has decreased by 8%.

Almost one in ten businesses now believe they are at risk of insolvency (9% - taking 'very likely' and 'fairly likely' together).

Perceived likelihood of insolvency over the next 12 months:



Extrapolating the data, this equates to approximately 46,000 businesses saying they are 'fairly likely' to go into insolvency in the next twelve months, and 96,000 saying they would be 'very likely' to do so. Taken together, this equates to 142,000 businesses. This compares to just over 26,000 corporate insolvencies in 2009.



R3 President Steven Law interprets the results:

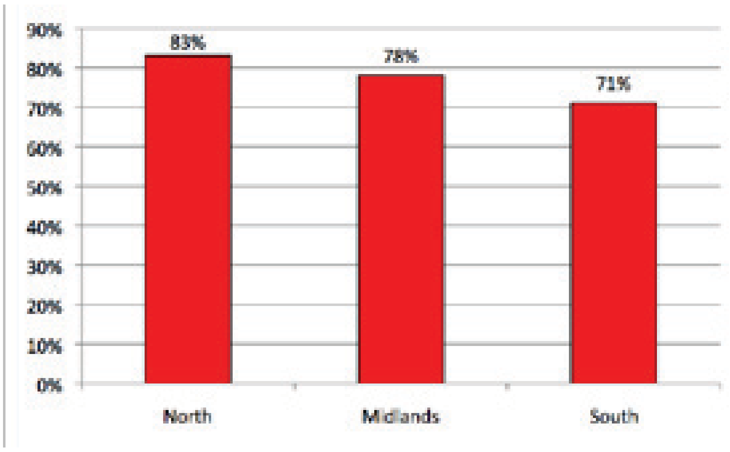
"We would see a significant rise in insolvencies this year if the businesses that say they are 'likely' to go into insolvency in fact do so. This would fit the pattern usually exhibited after a recession, with an insolvency 'peak' some time after a return to growth. Much will depend on when interest rates rise, whether HMRC continue to operate the Time to Pay scheme, how the VAT rise will impact on certain sections of the business community, and the effects of the public sector cutbacks on the private sector.

"It is important to remember that a rise in corporate insolvencies does not automatically result in a rise in business closures. Insolvency Practitioners have a range of business rescue options open to them, and usually spend around a quarter of their time on insolvency prevention and business rescue. In fact, we would expect to see more businesses rescued as economic conditions improve, as there are more buyers in the market and creditors are more likely to support rescue schemes."

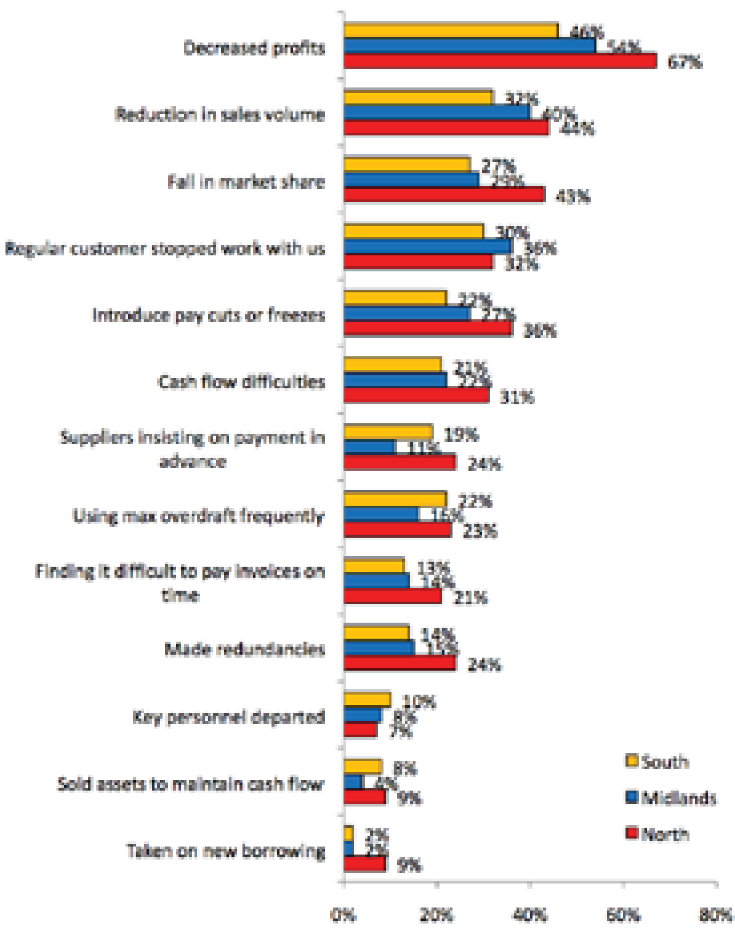
Demographic analysis: business region, sector and size

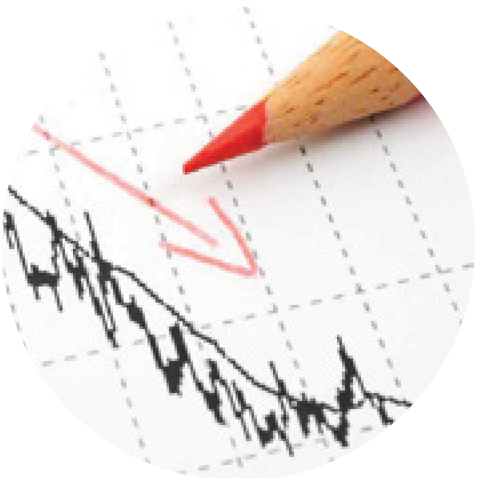
Business region

Signs of distress:
The following graph shows the percentages of businesses in each region that are experiencing at least one sign of distress. Businesses in the North are more likely to be experiencing at least one distress sign (83%) than those in the Midlands (78%) and the South (71%).

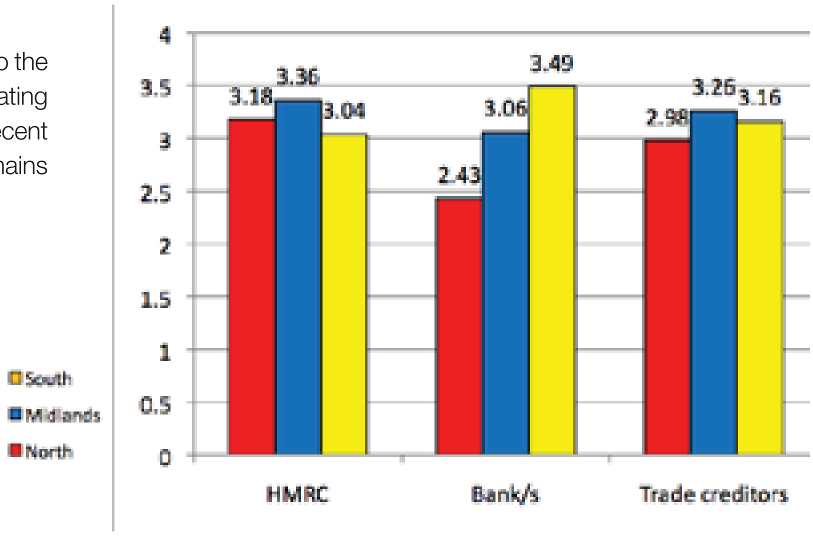


Businesses based in the North are more likely than those elsewhere to experience many of the distress signs listed, while businesses in the South are often the least likely to do so. The picture for businesses in the North is concerning, with 67% experiencing decreased profits, 44% seeing a reduction in sales volume, more than a third introducing pay freezes/cuts (36%), 31% experiencing cash flow difficulties, a quarter (24%) making redundancies and around one in ten taking on new borrowing to pay down existing debt and selling assets to maintain cash flow (both at 9%).



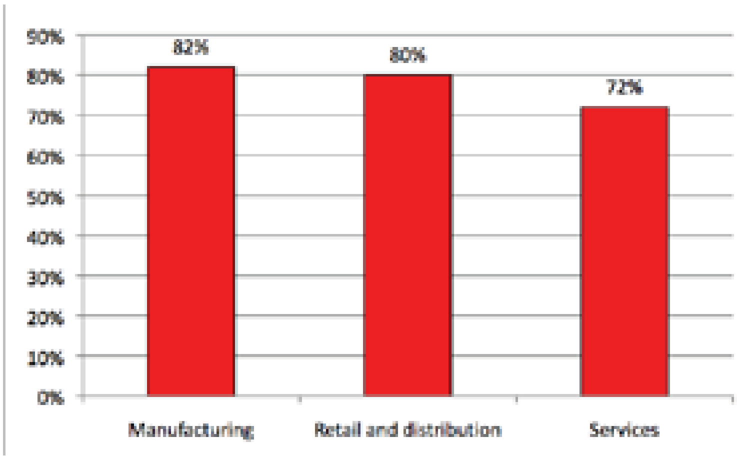


Creditor behaviour:
Businesses in the North award a lower mean score to the banks than businesses elsewhere (2.43), demonstrating a more negative view of bank support in the most recent three months. The perception of other creditors remains fairly similar across the regions.



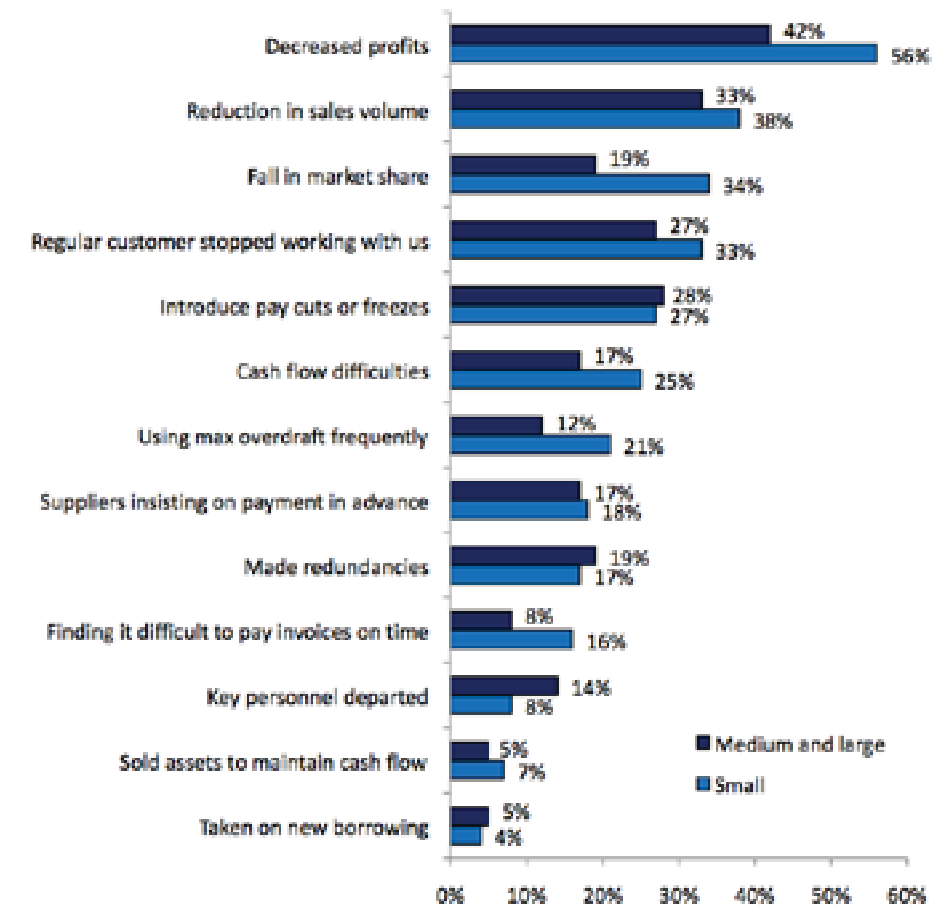
Business sector

Signs of distress:
The following graph shows the percentage of businesses in each sector that are experiencing at least one sign of distress. Businesses in the manufacturing sector are more likely to be experiencing at least one distress sign (82%) than those in the retail and distribution and services sectors (at 80% and 72%, respectively).

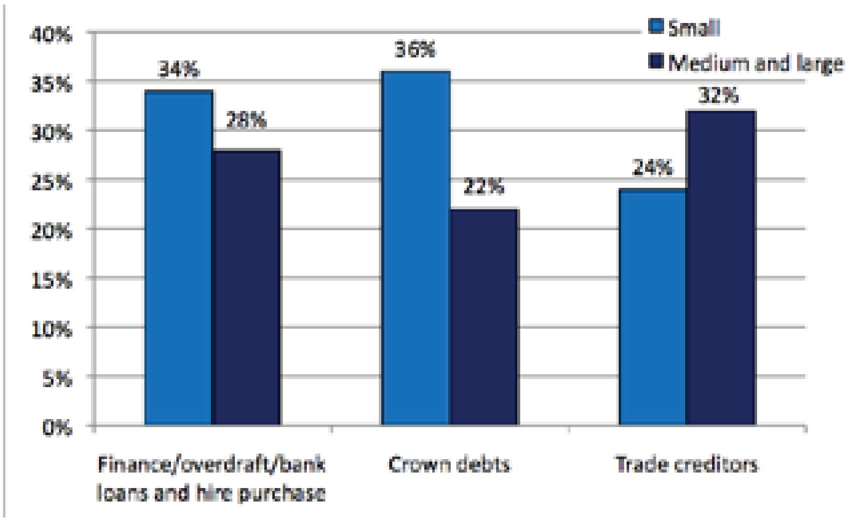


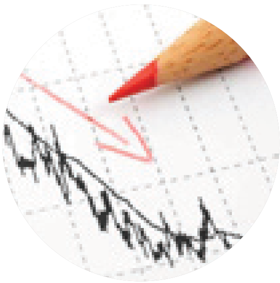
Business size

Signs of distress:
With the exception of employee related signs of distress, small businesses tend to be more likely than medium or large businesses to experience key signs of distress.



Of those concerned about their debts, smaller businesses are also more likely to be concerned about each type of debt than their larger counterparts:





Methodology note: BDRC Continental conducted 501 telephone interviews with small, medium and large business owners and FDs between 29th November and 10th December 2010. Quotas are set by size, region and sector and the data weighted to the profile of GB businesses. The respondent in each case is a senior financial decision maker. Where figures are mentioned, estimates have been extrapolated using the percentages from the results and the number of businesses for Great Britain. Small businesses are those with a turnover of £50,000 to £1million pa; medium and large businesses are those with a turnover of more than £1million pa.

About R3

R3, the trade body for Insolvency Professionals, represents over 97% of Insolvency Practitioners. R3 members are trained and regulated accountants and lawyers who have extensive experience of helping businesses and individuals in financial distress.