Business DISTRESS Index third wave

Welcome to the third wave of insolvency trade body R3's 'Business Distress Index' – a key quarterly barometer of the financial position of GB businesses. The third reading was taken in March 2011.

Overall, the Index paints an encouraging picture for businesses, as key signs of distress are on the decline. However, there is a worrying minority of businesses whose debt concern has intensified over this quarter while they experience some of the most worrying signs of financial distress.

Over the course of the last quarter, fewer businesses are experiencing key signs of distress. However, while the number of businesses concerned about their debts or fearing insolvency has remained at similar levels this quarter, those who are worried about their debts are becoming increasingly concerned about their Crown, bank and trade debts. For this significant minority, worry about debt has intensified since the last quarter.

One in ten businesses currently fear insolvency and a significant minority are still suffering key signs of distress. 18% are unable to pay their invoices on time and 20% have found their suppliers insisting on payment in advance. This group may be particularly at risk as the inability to pay bills when they fall due is the cash flow test of insolvency.

Frances Coulson looks at the report:

This report is very much a tale of two halves. It is extremely positive that fewer businesses are experiencing key signs of distress, yet difficulties among a concerning minority of businesses has intensified. The effects of public sector cutbacks or interest rate rises are likely to be keenly felt among this group.

Signs of distress are decreasing among businesses

But one in ten businesses fear insolvency

An increase in the number of businesses that 'strongly disagree' with banks being supportive

Intensifying worry about crown debts, bank debts and trade debts among businesses concerned about their debts

Signs of distress:

- The overall picture suggests businesses have fared better this quarter. Fewer businesses are experiencing key signs of distress. There have been decreases in the number of businesses experiencing decreased profits (40% - 14% down on last quarter); reduction in sales volume (30% - down 7%) and loss of regular customers (18% - down 14%).
- However, certain key signs of distress have increased since the last quarter. There have been increases in the number of businesses whose suppliers are insisting on payment in advance (20% - up 2%); finding it difficult to pay invoices on time (18% - up 2%) and releasing key personnel (12% - up 4%).
- The most common signs of distress remain a decrease in profits; a reduction in sales volume; loss of regular customers and a fall in market share.
- Small businesses are more likely to be experiencing signs of distress than their larger counterparts.
- Retail and distribution businesses are most likely to be experiencing signs of distress, while manufacturing businesses were most likely to be in this position last quarter.

Debt concern:

- Concern about debt levels has plateaued over the last quarter, with 24% of businesses concerned about their debts, compared to 25% last quarter. However, concern is still higher than it was in September 2010 – up 5%.
- For the businesses that are concerned about their debt, their worry has intensified: there has been a 9% increase in concern over bank loans and other finance; a 3% rise in concern over crown debts and a 12% increase in trade creditor debts.

Insolvency Fears

- The perceived likelihood of entering insolvency has remained the same this quarter, though there has been a 6% increase on September 2010 figures. Currently, almost one in ten businesses (9%) fear they may go insolvent in the next 12 months.

Creditor Approach

- During the last quarter, businesses believe they have seen a slight increase in the support shown to them by the banks and trade creditors. Overall businesses see trade creditors as their most supportive creditor, followed by HMRC and then the banks.
- Retail and Distribution businesses find creditors to be most supportive, which may reflect the fact that distribution firms are more likely to be experiencing difficulties at the present time, as shown by the 'distress index' and therefore have called on these creditors for support.

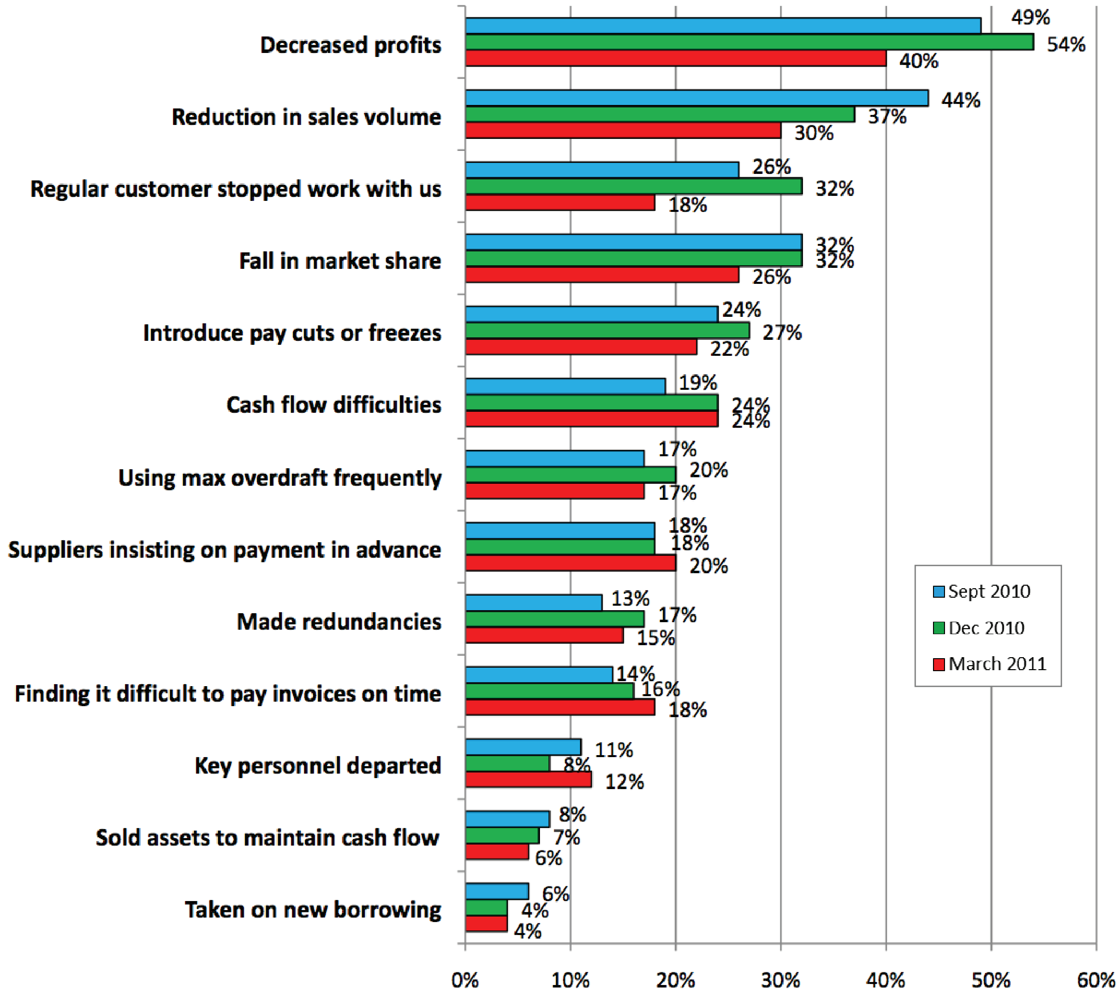
Signs of Distress

R3 has identified key signs of business distress, using this survey to identify how many GB businesses have recently experienced each sign.

Fewer businesses are experiencing key signs of distress compared to December 2010, with 72% of businesses experiencing at least one sign of distress, compared to 77% in the last quarter and 75% in September 2010. There have been key decreases in the number of businesses experiencing reduced profits, reduction in sales volume, and regular customers no longer working with the business.

However, there have been increases in other distress signs. In the last quarter there has been a jump in the number of businesses seeing suppliers insisting on payment in advance; finding it difficult to pay invoices on time and seeing key personnel depart.

Percentage of businesses experiencing each sign of distress



R3 President, Frances Coulson, looks at the results…

It's encouraging to see fewer businesses experiencing decreased profits. This is the lowest it has ever been over the three quarters. In fact all the five most common signs of distress have decreased since the Index's inception. This is hugely positive for businesses and suggests that the impact of the snow disruption in the last quarter was a 'one off' and has not resulted in a chain reaction in later months.

This exemplifies the importance of businesses having sufficient reserves to weather short term difficulties. Many other signs of distress have returned to similar levels seen in September 2010.

Despite many encouraging results, I remain concerned with the significant minority of businesses that are still experiencing difficulties paying invoices on time, seeing their suppliers insist on payment in advance and suffering cash flow difficulties. All of these are deeply concerning warning signs. As the country has moved out of recession, businesses that were suffering should now begin to see their situations improving. While the majority are in this position, a worrying minority are continuing to struggle, which is of real concern when interest rates remain low and creditors are being supportive.

Number of businesses experiencing each sign of distress

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

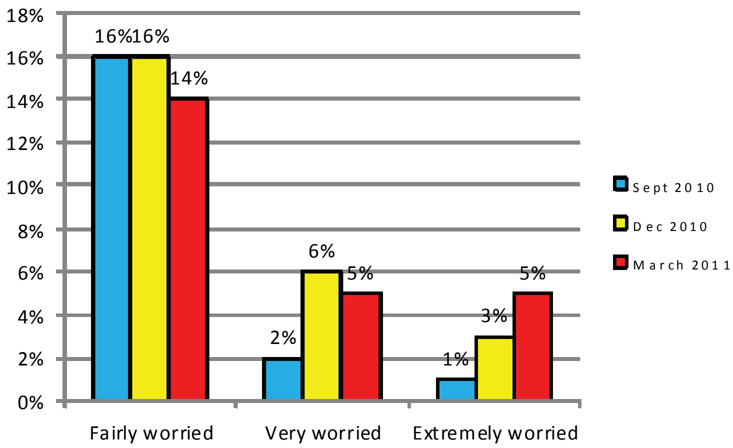
Signs of Distress	Sept 2010	Dec 2010	March 2011	Increase (>) or decrease (<) from December
Decreased profits	854,000	934,000	692,000	< 242000
Reduction in sales volume	751,000	647,000	521,000	< 126000
Fall in market share	548,000	553,000	451,000	< 102000
Regular customer stopped work with us	451,000	557,000	312,000	< 245000
Introduce pay cuts or freezes	419,000	473,000	377,000	< 96000
Cash flow difficulties	321,000	414,000	407,000	< 7000
Suppliers insisting on payment in advance	315,000	310,000	344,000	> 34000
Using max overdraft frequently	293,000	350,000	287,000	< 63000
Finding it difficult to pay invoices on time	240,000	268,000	313,000	> 45000
Made redundancies	229,000	294,000	262,000	< 32000
Key personnel departed	182,000	144,000	202,000	> 58000
Sold assets to maintain cash flow	139,000	124,000	104,000	< 20000
Taken on new borrowing	107,000	70,000	68,000	< 2000

Concern about debt levels

A significant proportion of the business community remains concerned about their levels of debt. Overall concern has remained stable from the last quarter; with 24% of businesses worried about their debts compared to 25% last quarter.

Although overall debt worry is relatively stable, there has been an increase in the numbers of businesses who are either 'very' or 'extremely' worried (10% this quarter, up from 9% in the last quarter and from 3% in September 2010). This suggests their debt problems have intensified over the last three months. Certain businesses that were 'fairly' worried may now have become 'very' or 'extremely' worried.

Percentage of businesses that are concerned about debt, to varying degrees:



R3 President, Frances Coulson, Comments:

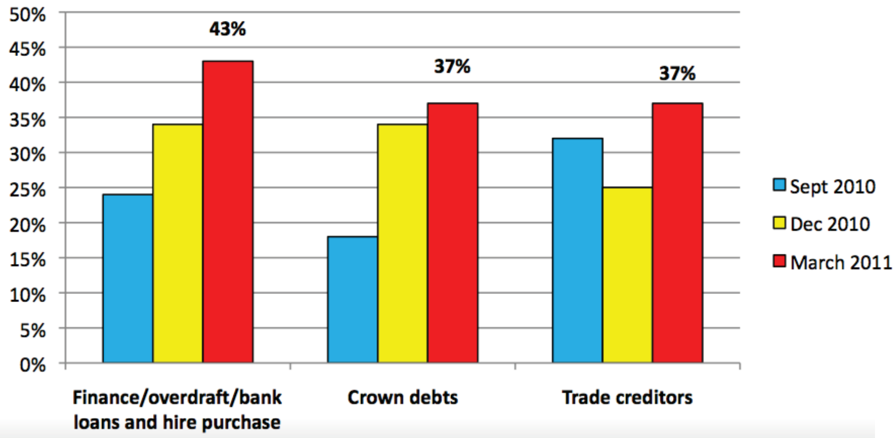
An intensification in worry among businesses that are concerned about their debts points to an alarming minority in the business community struggling to address their financial woes. If these distressed businesses continue along this downward trend they may lose control of their mounting debt, leading to insolvency in the coming quarter.

Concern about different types of debt

Of those who are worried about their debts, concern has increased across all types of debt. Most noticeably, there has been a significant quarter on quarter increase in concern over bank loans and other finance debt, standing now at 43% of businesses who are concerned about their debts. This compares to just 24% in September 2010 and 34% in December 2010. This equates to an average 9.5% increase per quarter and may point to an intensification of financial difficulties among those who have been struggling for a number of quarters. Overall, finance and bank loans remain the type of debt businesses are most concerned about.

Concern over crown debts has also increased among those concerned about their debts (up by 3% on the last quarter) and concern about debts owed to trade creditors has increased to 37%, jumping 12% on last quarter's figures.

Of the businesses concerned about debts, the percentages who are concerned about each type of debt:

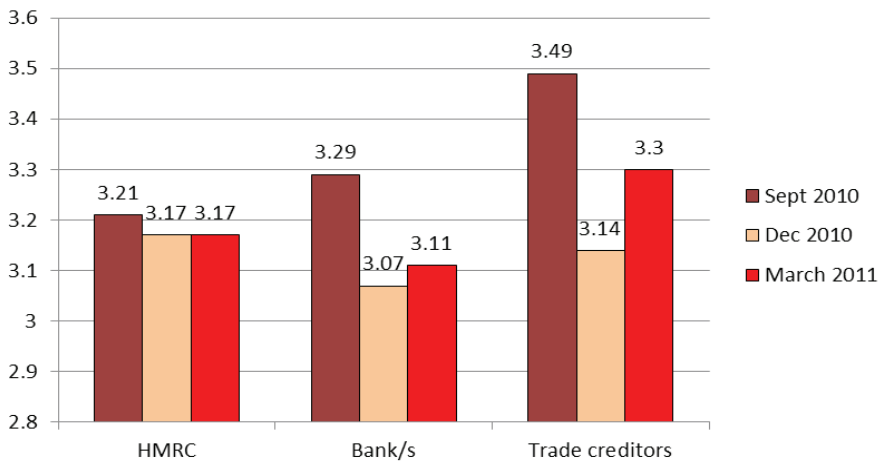


Attitude of creditors over the last quarter

Businesses were asked whether they disagree or agree with creditor groups being supportive over the last three 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, 'disagree slightly' = 2 and 'disagree strongly' = 1. The higher the mean score, the more businesses perceive that creditor to be supportive.

Businesses' overall perception of creditors being supportive has improved over the last quarter. Businesses perceive trade creditors to be the most supportive creditor, but less so then they were 6 months ago. HMRC follows as the next most supportive creditor, followed again by the banks.

Mean scores attributed to each creditor group's perceived support:



R3 President Frances Coulson explains…

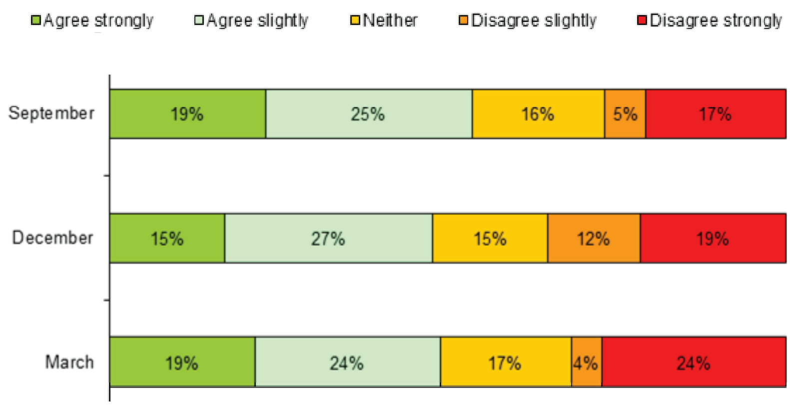
HMRC no longer being viewed as the most supportive creditor may be due to the revenue tightening up on its Time to Pay scheme, widely credited with stemming the tide of insolvencies during the recession by giving businesses more time to pay certain tax debts. Insolvency Practitioners working with businesses 'at the coalface' are seeing an increase in Time to Pay applications being rejected. Although it is a scheme R3 has supported to help viable businesses in difficult times, there is a growing concern that the scheme is being repeatedly used by businesses who are using it as an alternative credit facility and are not viable - 'zombie' businesses. More than two thirds of current Time to Pay arrangements are in default and many of these are business failures waiting to happen.

Are the banks helping the business community?

There are polarised opinions amongst the business community about the helpfulness of the banks during the recent recession and recovery. R3 has surveyed businesses on a quarterly basis to track this over time. The latest quarter shows an increase in the number of businesses who 'strongly disagree' with the statement that banks are supportive, up to 24%. This is an increase of 5% on the last quarter and a 7% increase on September 2010 figures.

However, overall, the picture shows that more businesses believe banks have been supportive in recent times than those that hold the opposite view – 53% of businesses believe the banks have been supportive while 28% feel they are unsupportive.

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



R3 President, Frances Coulson, Comments:

The increase in the number of businesses who disagree strongly that the banks have been supportive may reflect a worrying minority of the business community who may be struggling to service their existing debts or finding it hard to acquire more credit.

Likelihood of insolvency over the next 12 months

There are currently around one in 10 businesses that believe insolvency is likely in the next 12 months (9%), the same proportion as last quarter. This figure is still substantially higher than September 2010, which stood at 4%.

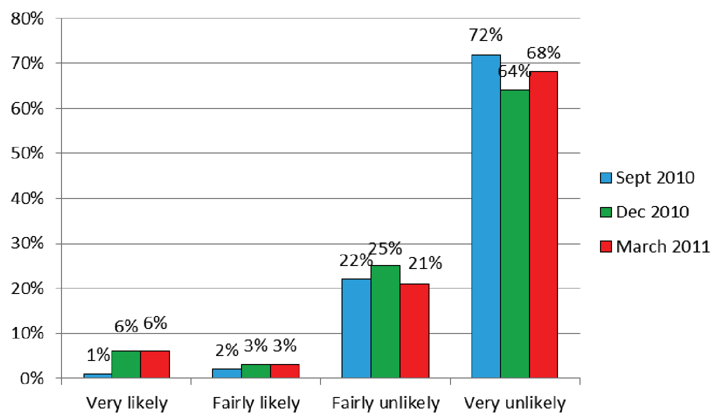
Frances Coulson, Comments:

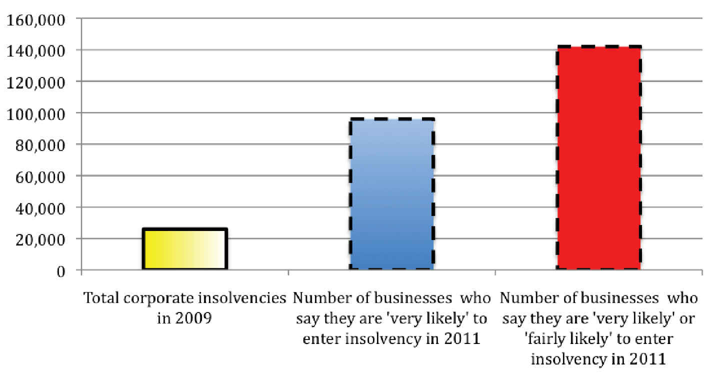
This is surprising as December was an uncharacteristically difficult month for businesses due to the adverse weather conditions. We would therefore expect businesses to have had a bleak outlook at this time, which should dissolve now conditions have ostensibly improved. This indicates very serious problems that have not been resolved for a minority of businesses.

Extrapolating the data, this equates to approximately 46,000 businesses saying they are 'fairly likely' to go into insolvency in the next 12 months and 102,000 businesses who say they are 'very likely' to do so.

Adding these numbers together, an estimated 148,000 businesses would enter insolvency in the next 12 months.

The perceived likelihood of insolvency remains at 9%, the same as the last quarter.

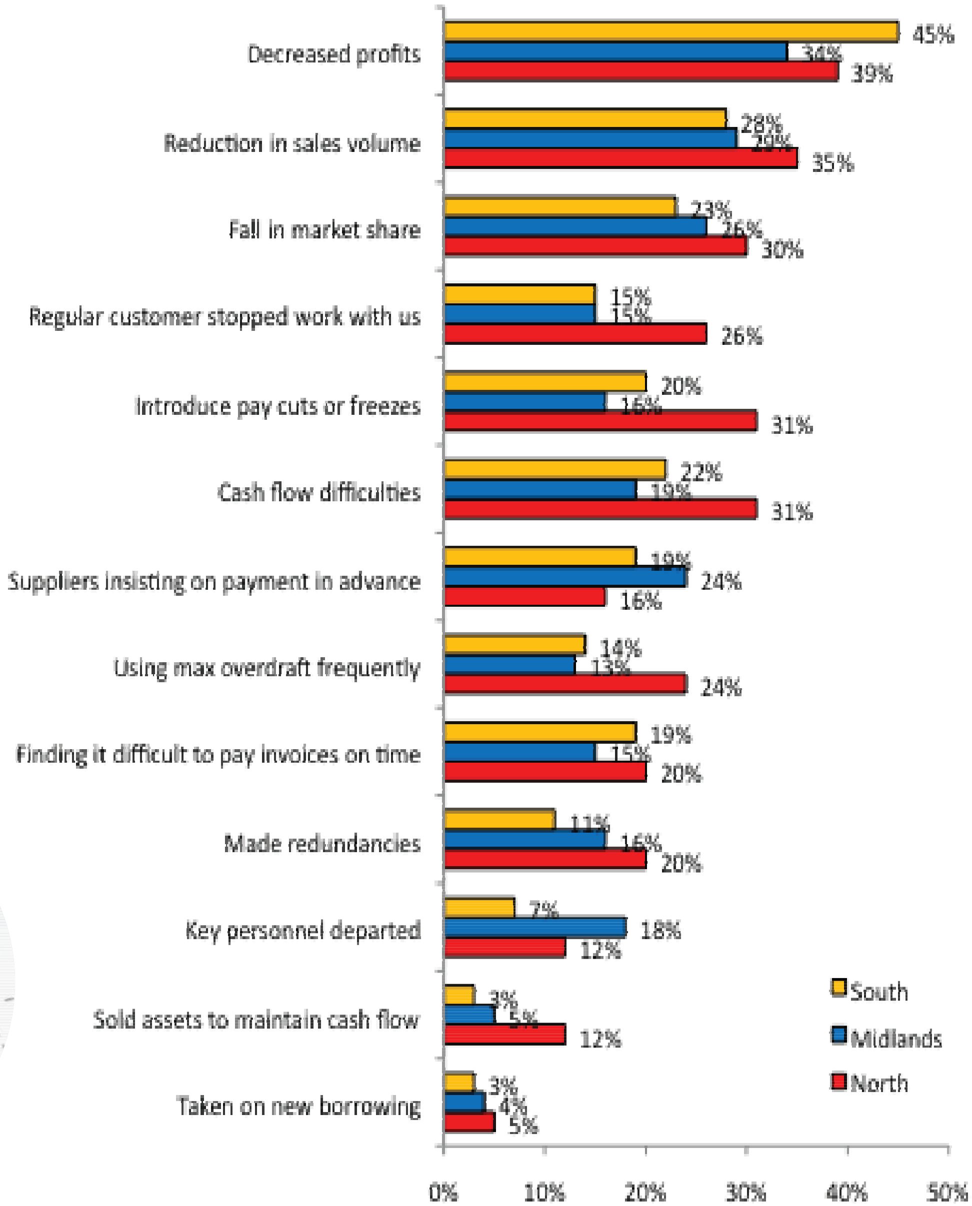


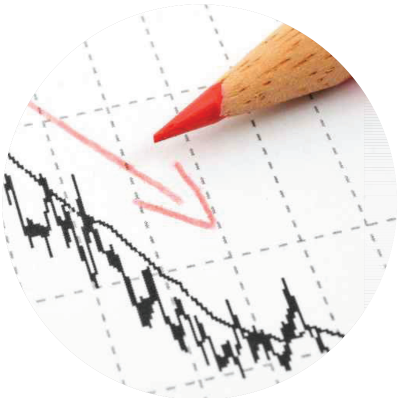


Demographic analysis: business region, sector and size

Business region

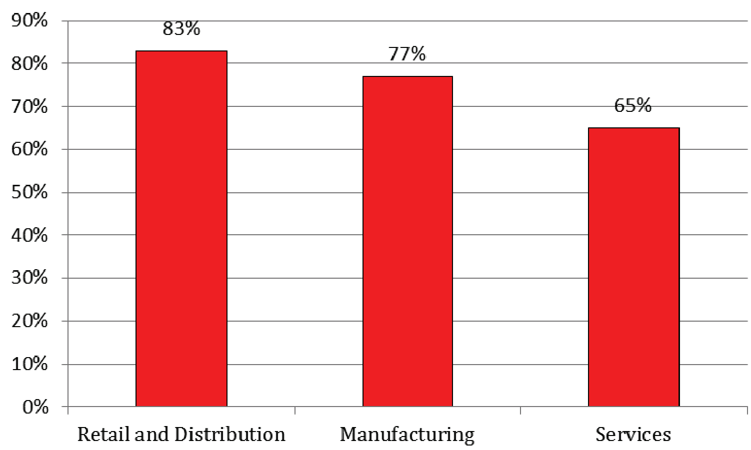
There are significant differences between the North and other regions, in signs such as introducing pay cuts (31% compared to 16% in the Midlands and 20% in the South); cash flow difficulties (31% compared to 19% in the Midlands and 22% in the South); using a maximum overdraft facility frequently (24% compared to 13% in the Midlands and 14% in the South) and loss of regular customers (26% compared to 15% in both the South and the Midlands).





Signs of distress by sector

The chart shows the percentage of businesses in each sector that are experiencing at least one sign of distress. Businesses in the retail and distribution sector are most likely to be experiencing at least one sign of distress at 83%, compared to manufacturing at 77% and services at 65%.



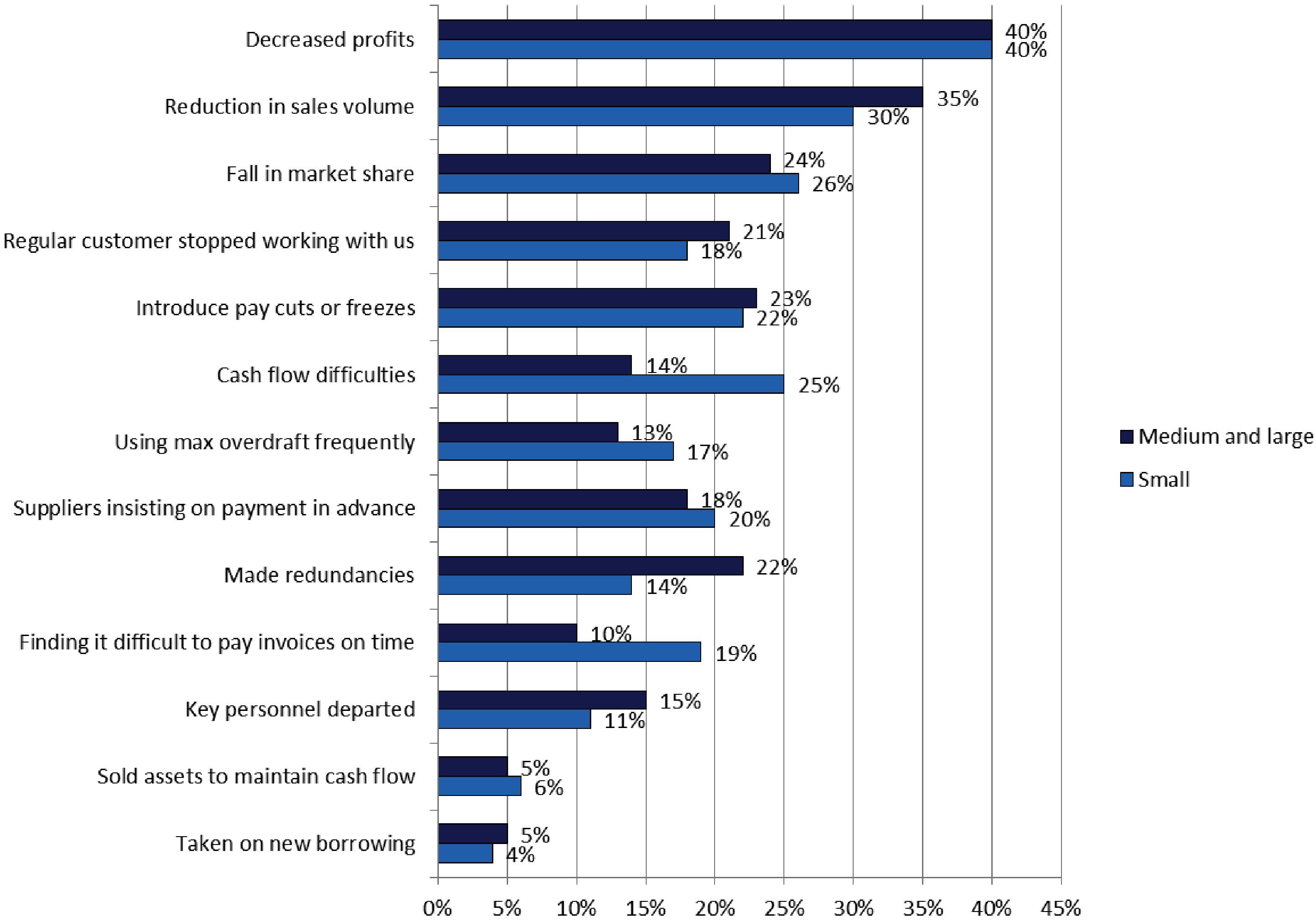
R3 President,
Frances Coulson, Comments:

With VAT rises being absorbed by many retailers and evidence that consumers are tightening their purse strings, it is not surprising that the retail sector, in particular, is showing more signs of distress.

Signs of Distress by business size

In previous quarters, small businesses tended to be more likely to experience various distress signs than their larger counterparts. This time there is more of a mixed picture. A much greater proportion of small businesses compared to larger businesses are experiencing cash flow difficulties; a fall in market share; difficulty in paying invoices on time and selling assets to maintain cash flow. By contrast, a greater number of medium and large businesses have seen their key personnel leave; experienced a reduction in sales volume; redundancies and loss of regular customers.

Signs of Distress amongst small and large businesses



R3 President, Frances Coulson, Comments:

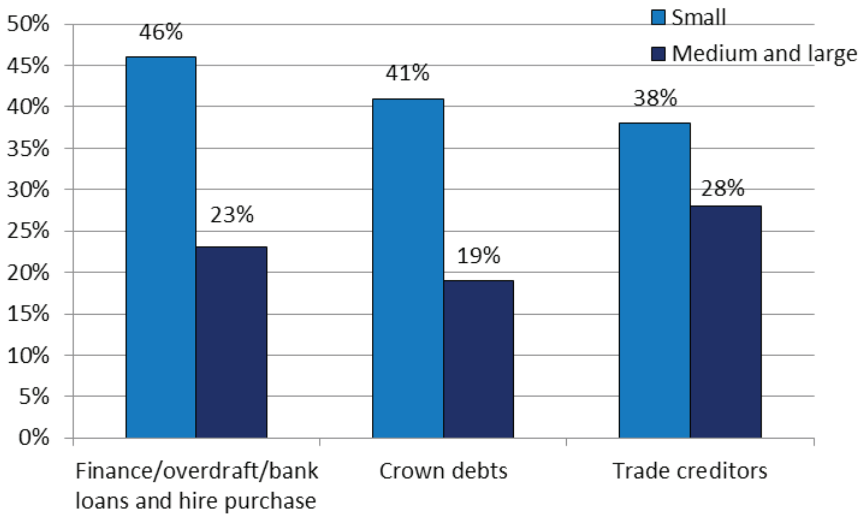
It is interesting to see that most of the distress signs small businesses are experiencing are tied to cash flow. This is of concern as small businesses are likely to have a much smaller 'buffer zone' compared to large and medium businesses.

Large and medium firms are surviving by allowing key personnel to depart (15%) and making redundancies (22%). This is clearly a lot more feasible in larger firms than smaller ones where there are fewer staff and the personnel can be critical to the business's success.

Of those businesses that are worried about their debt, small businesses express most concern about their debts, across all credit types.

The number of small businesses concerned about their debts has increased across all debt type groups since the last quarter. 46% are now worried about bank loans and other finance debt, compared to 34% last quarter. 38% of small businesses are now worried about debt owed to trade creditors, a jump of 14% from the previous quarter. Concern about crown debts has also risen (at 41%, a 5% rise from the previous quarter).

Of the businesses concerned about debts, the percentages who are concerned about each type of debt:



Methodology note: BDRC Continental conducted 501 telephone interviews with small, medium and large business owners and Financial Directors between 7th and 18th March 2011. 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.