R3 Business Distress Index: One in four businesses in the UK hit by domino effect (April 2018)

Research by R3, the UK's insolvency and restructuring trade body, suggests UK businesses in the UK have suffered financially due to the insolvency of a customer, supplier or debtor in the last six months.

Key findings

The figures, which are based on research by BVA BDRC, over a quarter (26%) of UK companies have suffered financially following the insolvency of a customer, supplier or debtor in the last six months body.

Domino effect

- R3's research shows that 10% UK businesses described the impact of the insolvency of another business as "very negative".
- One in six (16%) of UK businesses described the impact of the insolvency of another business as "very negative".
- 11% of firms experienced a material impact on their business following the insolvency of another business, while 47% reported that none of their suppliers, customers or debtors had entered an insolvency procedure in the past year.

Impact on businesses by sector and size

- Construction was the most vulnerable sector, as 47% of firms reported that the insolvency of another firm had had a negative impact on their finances in the last six months.
- The next most affected sectors were wholesale (35%), and transport (33%).
- 38% of firms with turnover of between £5m-£24.9m reported a negative impact of another companies insolvency on their finances, followed by 30% for larger companies (with turnover of £25m+) and 24% of smaller companies (up to £4.9m turnover).

R3 Commentary

Andrew Tate, Chair of R3's Policy Group and Head of restructuring and transformation at Kreston Reeves, said: "No business exists in isolation, and every headline-grabbing corporate insolvency will have consequences for numerous other enterprises. In the worst-case scenario, the loss of a vital business relationship can lead to a company's own insolvency in turn – the 'domino effect' in action. Recently, we have seen a string of insolvencies of high-profile companies, from Carillion to Toys R Us, which will have caused upheaval at other companies.

After the news of the Carillion liquidation broke, for example, our members reported an immediate upsurge in requests for advice from companies with links to Carillion. Many retailers have hit the headlines as a result of their current difficulties, causing less visible struggles at other firms, such as suppliers and service providers.

Often, the problems caused by the domino effect are ones that firms are able to weather, albeit with a hit to future turnover and profitability. The insolvency and restructuring profession has a role to play in helping to steady firms at risk of the domino effect, a task that would be easier with access to a more flexible set of tools, such as the business rescue 'moratorium' proposed by the Government back in 2016. Despite the help a

moratorium would offer a company dealing with a sudden shock, very little real progress has been made to introduce it.

The construction sector's networks of contractors, sub-contractors, sub-sub-contractors, and so on mean that it is highly interconnected, with the impact of one insolvency rapidly affecting other firms. The wholesale and transport sectors are both low-margin industries exposed to the ups and downs of the retail arena in particular, while the increasing demand for just-in-time logistics leaves little margin for error in either sector.

Middle-sized companies are less likely to have the same resources focused on credit control as larger ones, especially if they have grown rapidly without ensuring their systems have kept pace. Reliance on a single supplier or customer can also be an issue in this space, meaning that any difficulties in a supplier or customer may have a disproportionate effect

Any smart business knows it needs to mitigate risks due to insolvency in its supply chain or its customers through active monitoring of partners' credit profiles, diversification where possible to spread risk, and through building strong relationships that can provide support when a major counterparty hits a rough patch.

"If your business hears that a partner is in financial distress or is insolvent, calculate your potential exposure and seek expert advice immediately if it will be significant. You could also look to the possible upsides: could buying the distressed business help your own business? Can you pick up any new contracts or customers? Counterparty insolvency is likely to affect every business out there at some point so prepare as best you can, with a contingency plan in place"

About BDRC: Research undertaken by BDRC, an award-winning insight agency. Questions were put to 500 UK businesses via BDRC's monthly Business Opinion Omnibus. Telephone-based interviews with a nationally representative sample of senior financial decision makers across the UK, weighted by size, region and sector. Fieldwork dates 27th November to 7th December 2017

About R3: R3 is the trade association for the UK's insolvency, restructuring, advisory, and turnaround professionals. From senior partners at global accountancy and legal firms to practitioners who run their own small and microbusinesses, our members have extensive experience of helping businesses and individuals in financial distress. If you have any queries, or would like a meeting to discuss insolvency trends in the UK, please contact R3's Policy Executive, Mira Lodhia, on 020 7566 4202 or mira.lodhia@r3.org.uk