Business Distress Index January 2012

In 2011 the economy did not recover as expected. This report explores how businesses in Great Britain fared during the difficult economic climate and asks how they will cope in 2012.

Fewer businesses experiencing distress signs, however this figure is still nearly three fifths (58%) overall

29% of SMEs have seen a reduction in sales compared to only 6% of large businesses

Businesses with online payment facilities faring better than those without

66% of Greater London businesses suffering distress compared to national average of 58%

Distress signs are down

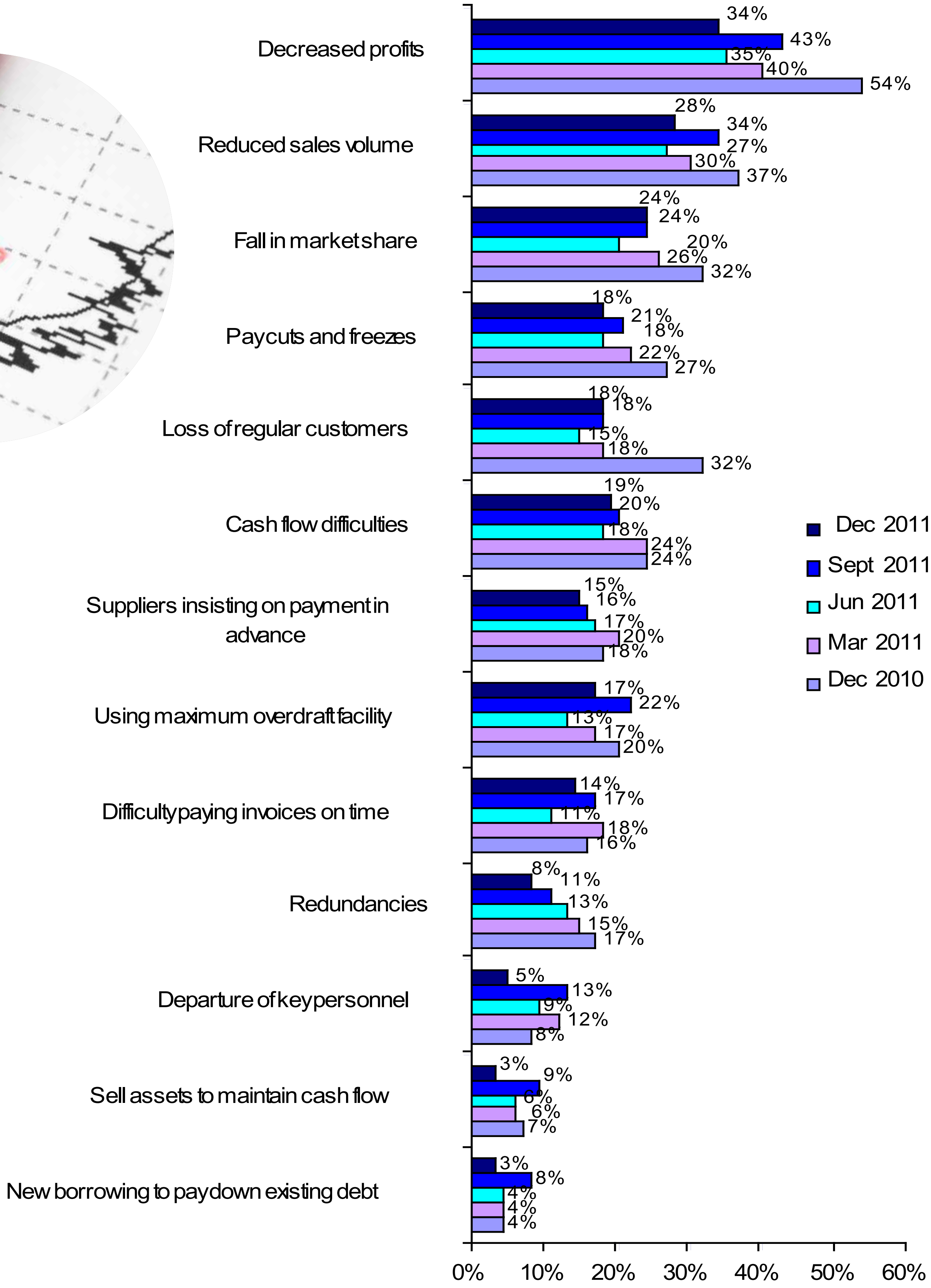
In December 2011, **58%** of businesses reported feeling 'signs of distress'. This is down by 10 percentage points on last quarter (**68%**) and significantly lower than a year ago (**77%**).

The expected widespread insolvencies have not occurred and this research indicates that businesses are starting to recover from the downturn. Could this be a sign that the economy is recovering or does it mean that there is an increase in 'zombie businesses', businesses that are hanging on even though they are no longer profitable and unable to grow?

Frances Coulson, R3 President, comments:

"Surprisingly, fewer businesses appear to be feeling signs of distress than this time a year ago but this could be the calm before the storm. Many 'zombie' businesses have been surviving but not thriving and we know that businesses do not fail in the middle of a recession, but when the economy is recovering. The 'insolvency lag' we have seen in previous recessions is slower to materialise this time around, and traditionally insolvencies increase during the recovery phase. This is because a company's financial outlook starts to improve and creditors stand to achieve greater returns than they would during the downturn. Furthermore, changes in the policies of lenders and the Government could force 'a clear out of the system', but whether this will happen in 2012 is doubtful."

Distress trends
December 2010 - December 2011



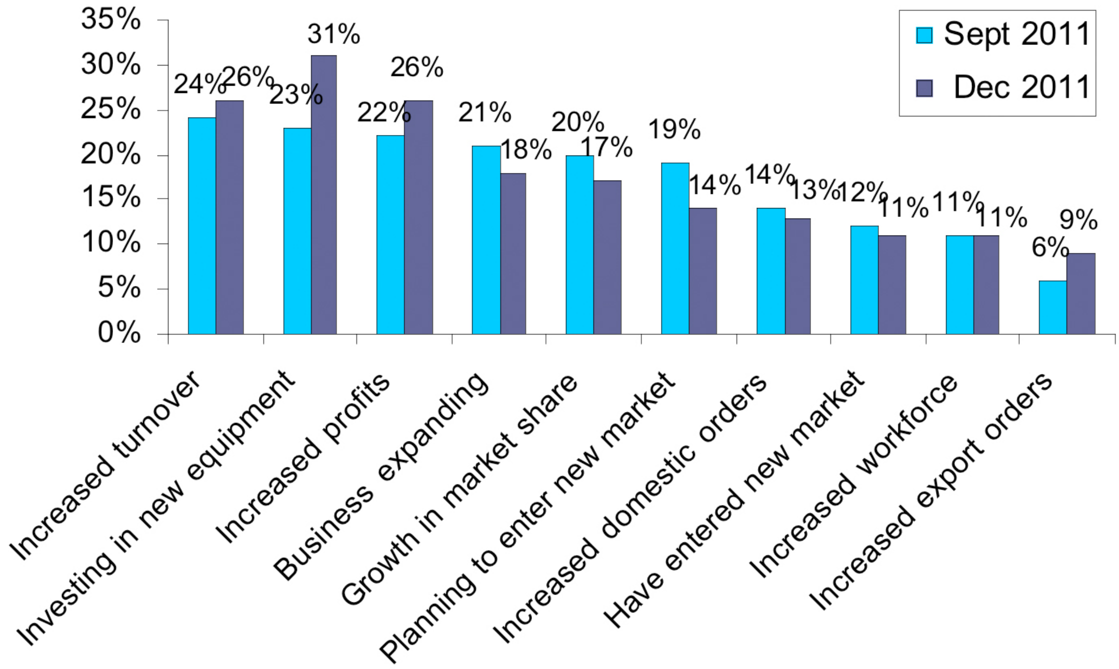
Growth signs - quarter on quarter

The growth indicators offer a mixed picture, with some signs increasing:

- **31%** of businesses say they are investing in new equipment, compared to **23%** last quarter
- **26%** are experiencing increased profits compared to **22%** last quarter

However, there has been a slight fall in other indicators:

- **18%** say their business is expanding, compared to **21%** last quarter
- **17%** say there market share has grown, compared to **20%** last quarter



Frances Coulson comments:

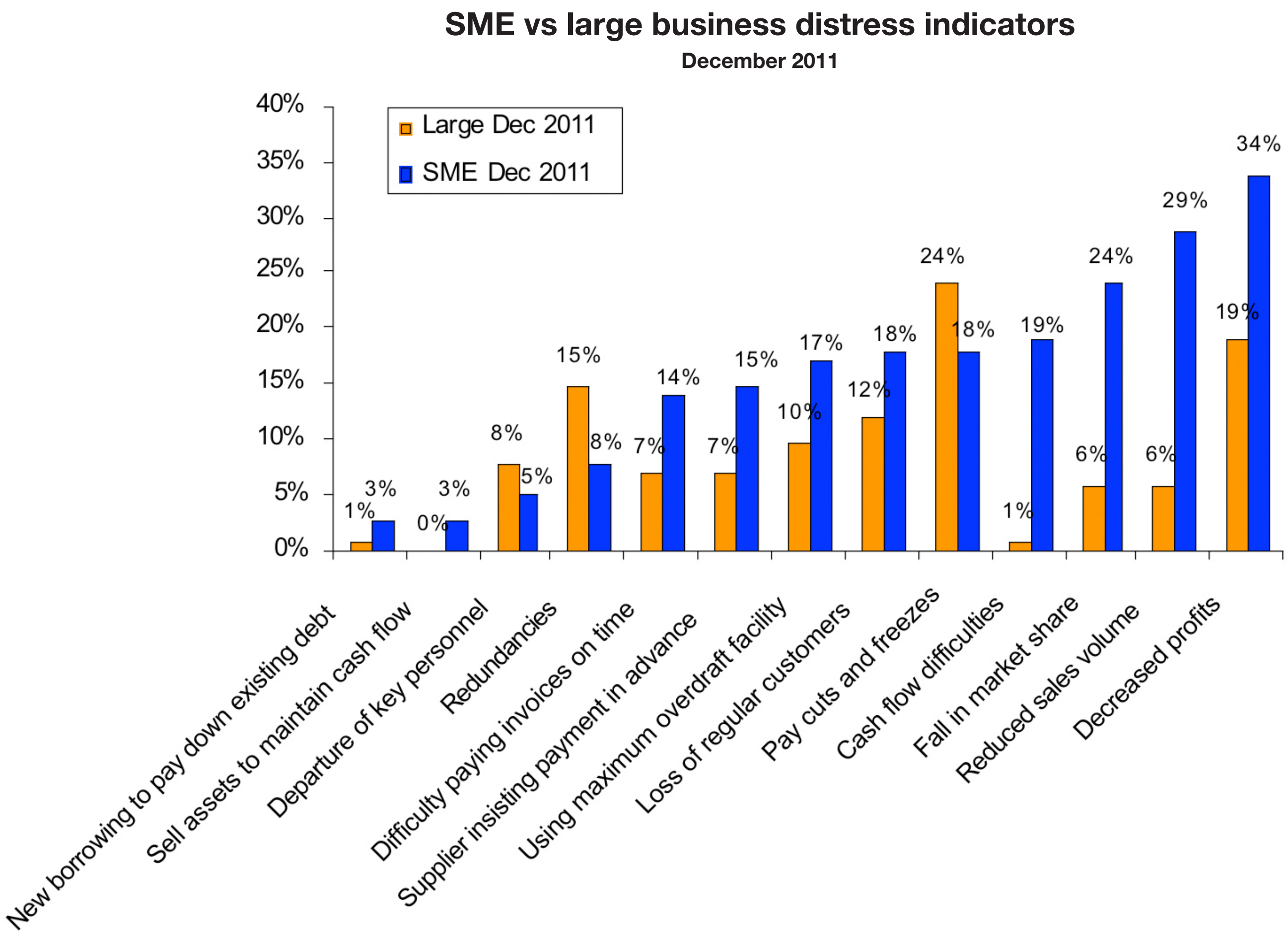
"This mixed picture seems to support the fact that businesses are not flourishing, and many are just hanging on. In order to be considered healthy, a business must be able to grow and many are struggling to do so. Any change in circumstances or sudden disruption is likely to cause serious difficulty for those who are not showing growth indicators."

SMEs

Growth in the SME sector was a planned part of the economic recovery. However, SMEs are struggling more than large companies, despite Government-backed schemes designed to support them.

Across 10 out of the 13 key signs of distress, more SMEs are struggling compared to large businesses. Most notably:

- over one third (**34%**) of SMEs are experiencing decreased profits, compared to **19%** of large businesses
- **29%** of SMEs have seen a reduction in sales volumes, compared to only **6%** of large businesses
- nearly a quarter (**24%**) of SMEs have seen their market share fall, compared to **6%** of large businesses



Frances Coulson comments:

"The Government has created a number of schemes to help support SMEs including the Enterprise Finance Guarantee Scheme and Enterprise Capital Funds. These were based on the fact that SMEs are vital to the health of the economy but need help to survive this difficult economic environment. However, it is clear that many SMEs are not financially robust enough to withstand the economic pressure. Either more support is needed in 2012 to enable a real recovery; or some businesses will inevitably fail rather than continue to limp along, damaging competition."

The ‘online’ effect

The consumer appetite for online shopping has grown year on year. Businesses such as Amazon continue to flourish, while high street shops such as HMV suffer.

This research indicates that businesses which are able to make or receive online payments are faring better than those who can’t.

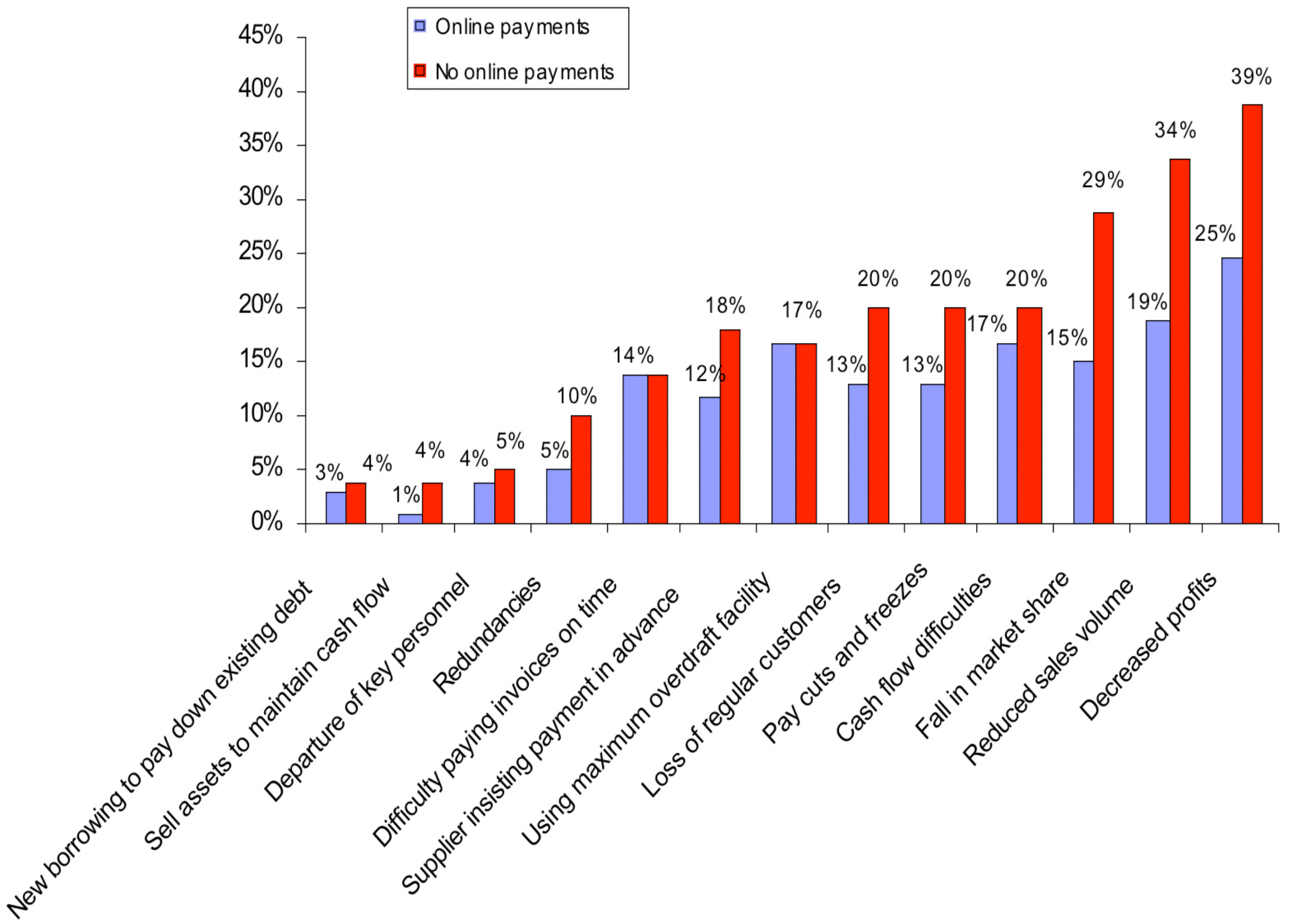
- **39%** of those who can’t make or receive online payments said they were experiencing decreased profits, this is compared to **25%** of those who can
- **34%** of those who can’t make or receive online payments said they had seen a reduction in sales volumes, compared to only **19%** who said they can
- **29%** of those who can’t make or receive online payments said their market share has fallen recently, this is compared to **15%** of those who can

Frances Coulson comments:

“The high street shops are suffering and Christmas was not enough to save many businesses. But the preference of using online services does not stop with the individual consumer, businesses also find it easier and quicker to make and receive payments online. In 2012, it is very likely that those who are not making use of online services to streamline basic business processes will get left behind.”

Distress signs for businesses with and without online payment facilities

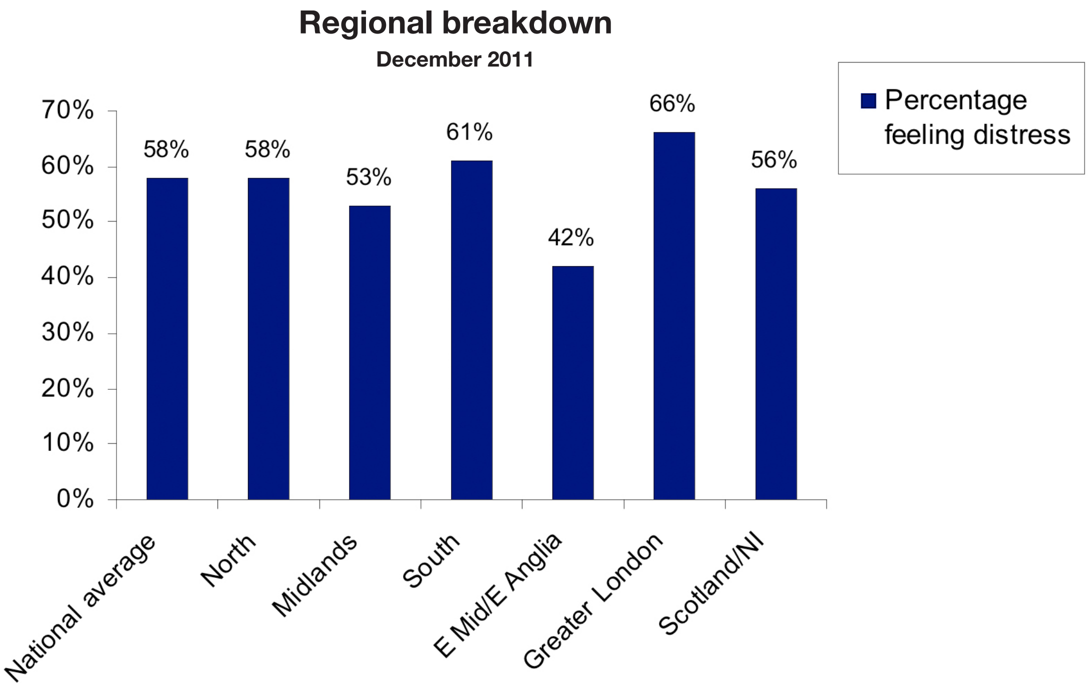
December 2011



Regional analysis

Businesses in the Greater London area are struggling more than any other region in the country with **66%** feeling signs of distress, compared to a national average of **58%**. Most notably:

- **26%** of businesses in London have found that one or more of their regular customers has stopped working with them, compared to a national average of **18%**
- **24%** have said that some suppliers are insisting on payment in advance, compared to a national average of **15%**
- and **19%** have had to make redundancies, compared to **8%** nationally



Frances Coulson concludes:

"2012 is set to be even more difficult than 2011. The political and economic impact of the Eurozone crisis will be keenly felt, particularly by small businesses. Consumer confidence is low and businesses in the Greater London area appear to be bearing the brunt of the distress. There are two rays of sunshine in the otherwise bleak outlook - this year's Olympics and the Queen's Diamond Jubilee. These events should be used as an opportunity to boost business and capitalise on the huge numbers of people coming to the UK for the games and celebrations."

Notes to the editor: SMEs are defined as businesses with a turnover up to £20million; Large businesses are defined as those with a turnover of over £20million.

Methodology note: BDRC Continental conducted 500 telephone interviews with small, medium and large business owners and Financial Directors between 28th November and 9th December 2011. Quotas are set by size, region and sector and the data weighted to the profile of UK businesses. The respondent in each case is a senior financial decision maker.

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.