Business Distress Index July 2012

In the months leading up to the Olympics, business distress signs are down and growth signs are up. However R3's Business Distress Index also finds that there are tens of thousand of 'zombie businesses' out there, suggesting that this boost may only be temporary.

146,000 zombie businesses in the UK – businesses that are only able to pay interest on their debts (8%)

Distress is down and growth is up for businesses across the country

Fewer businesses in London experiencing growth – only 17% investing in new equipment, compared to 36% nationally

Zombie businesses:

R3 asked businesses if they are experiencing any of the four 'zombie indicators' that could suggest businesses are nearing the point of insolvency, but are still just able to hang on - neither failing, nor thriving. Businesses that said they were experiencing one, or more of these signs, can be considered a 'zombie' business. The signs are:

- Just being able to pay back the interest on their debts, but not reduce the debt itself
- In the event of a rise in interest rates, the business will be unable to pay back debts at all
- Struggling to pay debts when they fall due
- Having to negotiate payment terms with creditors.

R3 research indicates that there are some **146,000 'zombie businesses'** in the UK (8% of businesses) who are only able to pay the interest on their debts but not reduce the debt itself. The same percentage reported that in the event of a rise in interest rates, they would be unable to afford to repay their debts at all.

Lee Manning, R3 President, comments:

"This is staggering number. 146,000 businesses in the UK are only able to pay the interest on their debts but not reduce the debt itself, and a similar number will be unable to repay their debts in the event of a rise in interest rates. The implication here is that these businesses have been 'running on empty' for quite some time now and with no reserves left in the tank, they won't be able to carry on for much longer.

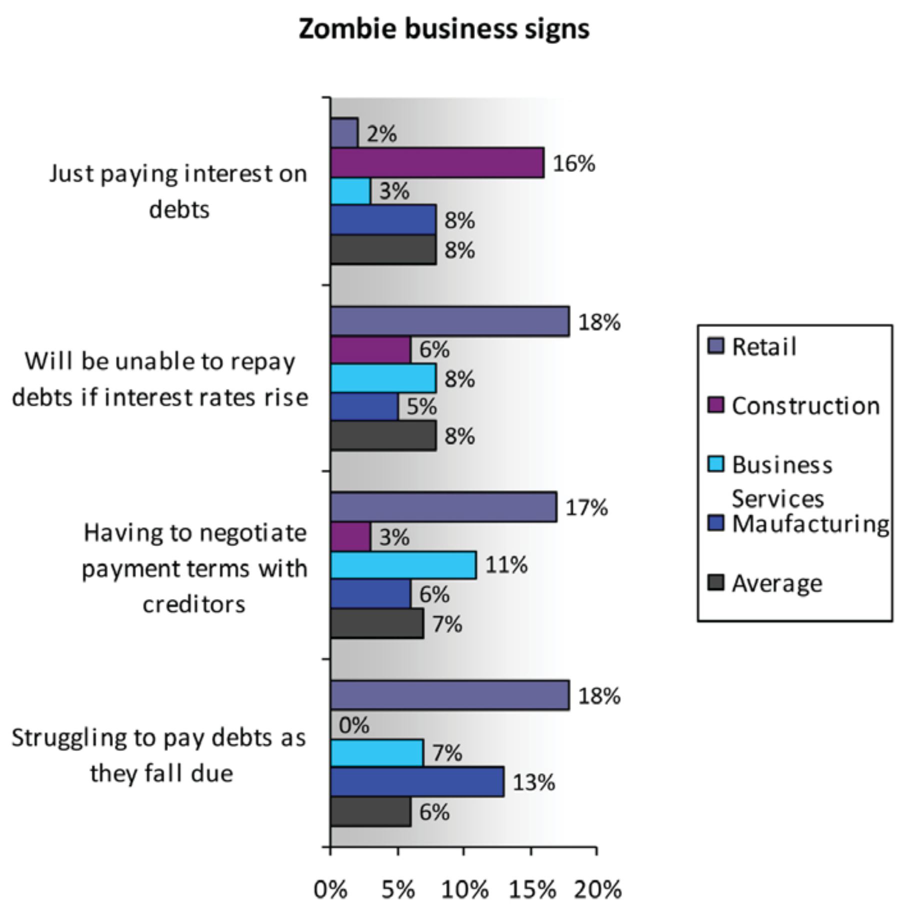
"The principle of business rescue is integral to the UK business culture, and so it is likely that some of these businesses can be restructured. However, the fact is, a large proportion of them will, and should be allowed to fail. It is uncompetitive to have such a volume of stagnating businesses in our economy."

Lee Manning, R3 President, comments:

"Essentially, a zombie business is one that is on the edge of insolvency but has been holding on, often for a prolonged period of time, not growing or changing for the better. An insolvent business is one that is unable to pay its debts when they fall due, or a business that has debts greater than the value of its assets. The danger for businesses that are teetering on the edge, is that any change of circumstances, such as a rise in interest rates, the loss of a major customer, or suppliers upping their prices will mean that they will not be able to hang on any longer."

The retail sector featured most prominently across three out of the four zombie business indicators and has the highest proportion of businesses will be unable to pay their debts in the event of a rise in interest rates - 18%, which equates to **31,000 businesses.**

However, **the construction sector** has the largest proportion of businesses that are only able to pay the interest on their debts - 16%, which equates to **37,000 businesses.**



Lee Manning comments:

"Devastation on the high street is well recorded. Since the start of 2011, over 21,000 jobs have been lost from the failures of major high street names, but we are yet to see the volume of construction failures that we would expect.

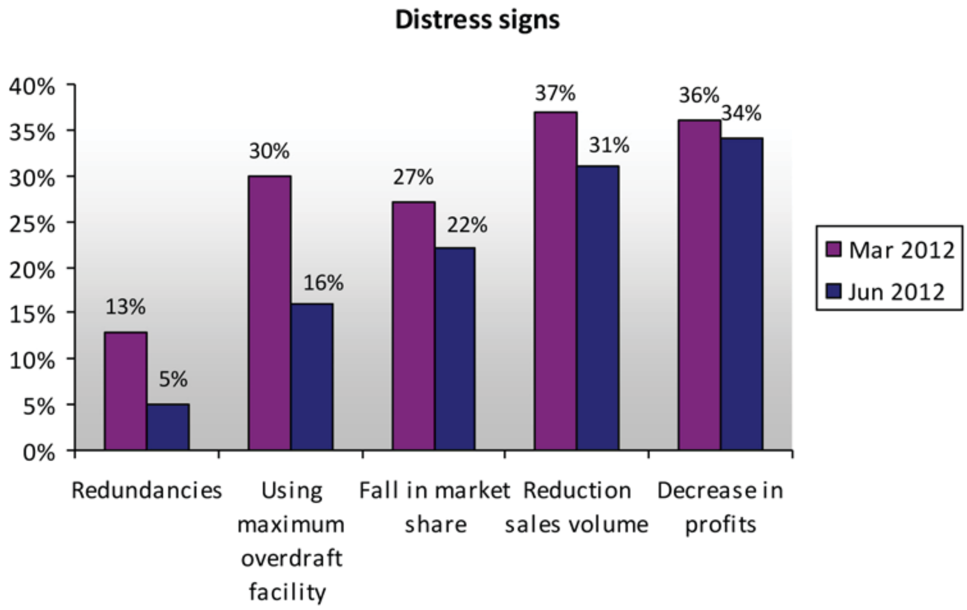
"With many capital expenditure projects coming to an end, cuts in public sector budgets and work from the Olympics having recently dried up, we can expect to see many of these businesses unable to hang on for much longer. Construction may well be the next big casualty from this recession."

The Olympic effect:

Business distress

In the second quarter of 2012, fewer businesses reported distress signs than did in quarter one. The research also finds that more businesses are experiencing signs of growth in the lead up to the Olympics.

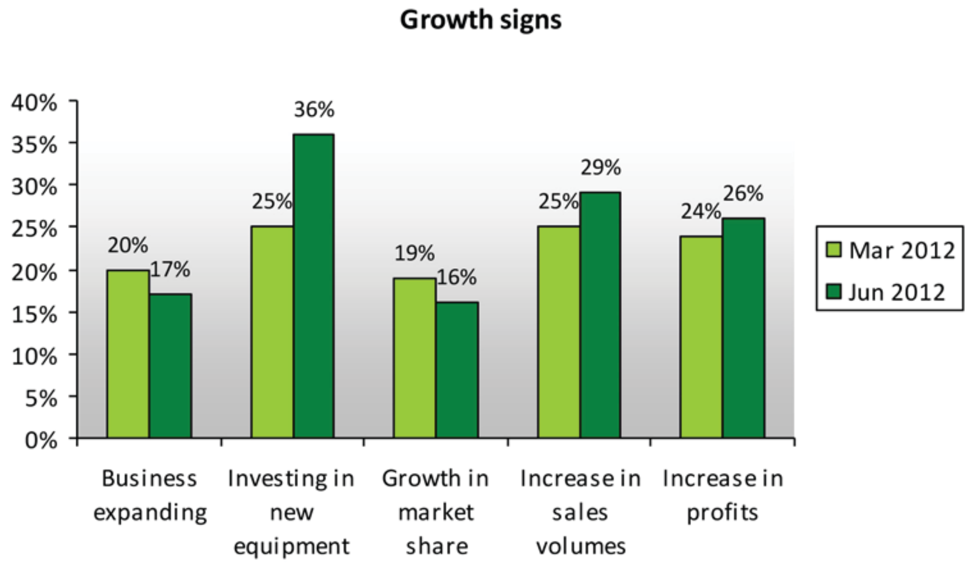
The percentage of businesses **regularly using their maximum overdraft facility (16%)**, has fallen by almost half since March 2012 and is the lowest it has been since this time last year. The percentage of businesses who said they **have had to make redundancies in the last three months (5%)** is also the lowest figure recorded in the last 12 months.



Business growth

On the whole, more businesses are also experiencing signs of growth, compared to the first quarter of 2012. The percentage that said they have **invested in new equipment (36%)** is up 11 points on the previous quarter.

The percentage that say their sales volumes and profits have increased is also up, but fewer are reporting that **their businesses is expanding**. The growth signs that more businesses seem to be experiencing, do not necessarily equate to the long term sustainability of the business, as fewer say they are growing or their market share has expanded.



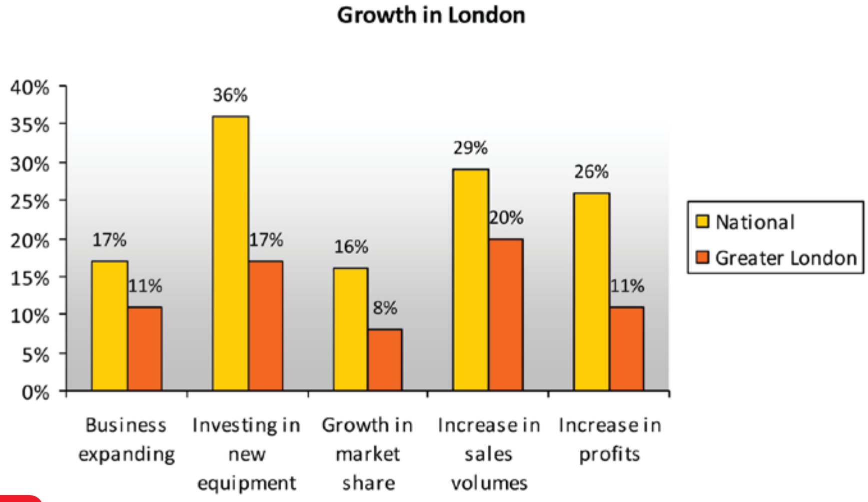
Lee Manning comments:

"Business distress is down in the months leading up to the Olympics and on the whole, growth is up. Although these are positive signs for the economy, this boost is likely to be as a result of the approaching Games and therefore only temporary.

"In fact, compared to the first three months of the year, fewer businesses are reporting a growth in their market share and that their business is expanding, even in spite of the fact that more are saying that sales volumes and profits have increased."

Growth in London

Compared to the national average, fewer businesses in London say they are experiencing signs of growth. Most notably, the percentage that said they **have invested in new equipment (17%), their market share has grown (8%) and their profits have increased (11%)**, is around half the proportion that reported the same nationally.



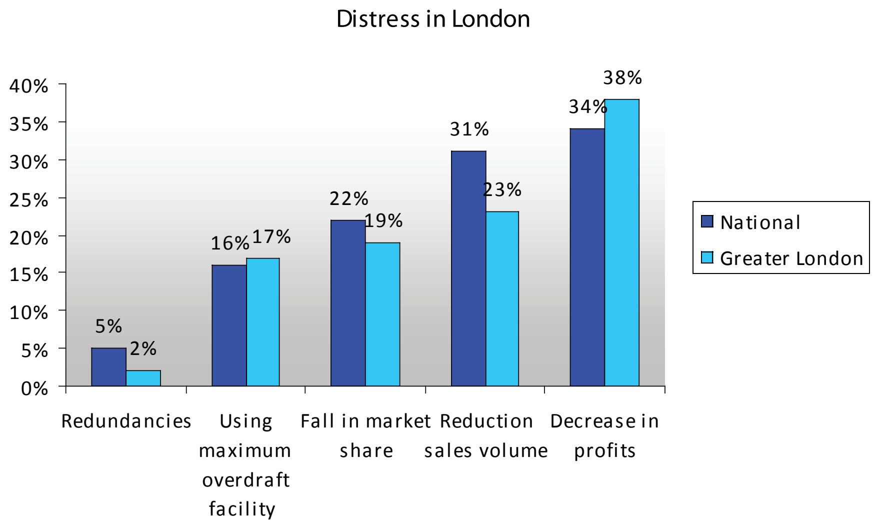
Lee Manning comments:

"Surprisingly, as London 2012 approaches considerably fewer businesses in London are reporting growth compared to the national average – it seems that London businesses are not performing as well as expected. This could be because tourists have been put off coming to the city because of the Games and perhaps even the weather, and so prominent industry sectors in London, like hospitality and leisure, are not experiencing the anticipated benefits.

"In the months that follow the Olympics, we can expect to see many businesses that are not experiencing growth, particularly in London, to start to struggle and large numbers are likely to fail."

Distress in London

Across most signs, fewer businesses in London are reporting distress compared to the average, just as fewer are also reporting growth. The Games seem to be relieving some of the distress in the short-term, but perhaps not in the longer-term.



Lee Manning concludes:

"The fact that fewer businesses in London are reporting distress is not necessarily an indication that they are healthy. Our research shows that they are not actually growing, or increasing their market share.

"The Games seem to be relieving some of the distress that businesses have been experiencing but this is only temporary, in the long term, they will not able to survive if they remain unable to expand."

Methodology note: BDRC Continental conducted 502 telephone interviews with small, medium and large business owners and Financial Directors between 6th-13th June 2012. Strict quotas are set by size, region and sector and the data weighted to be representative of the ONS profile of UK businesses, each with an annual turnover above £50,000. The respondent in each case is a senior financial decision maker.

About R3

R3, the insolvency trade body, represents over 97% of insolvency practitioners. R3's full members are all regulated by their recognised professional bodies, they can be licensed insolvency practitioners, solicitors, chartered accountants or certified accountants. They have extensive experience of helping businesses and individuals in financial distress.