If a Business Is Facing Distress, What Options Are There?

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There are a number of options and avenues that a company can explore when faced with business stress or distress. Depending on the circumstances, a combination of these could be appropriate to help mitigate or avoid a business failing.

This guide provides an overview of potential options and should be considered alongside specific advice from the company's advisors.

Informal Options

Even when informal options are being considered, directors should engage with their advisors and stakeholders to ensure that their decisions take into account their directors' duties.

For a guide to directors' duties when a company is in a distressed situation, see our quick guide.

Managing Cash Flow/Balance Sheet

- Negotiate with landlords and key suppliers
- Negotiate with HMRC
- Review key contracts and supply agreements
- Restructure the workforce
- Agree informal or formal compromises with creditors
- Close unviable operations or sell loss-making divisions
- Tighten debt recovery processes

Finance

- Increase existing facilities
- Easing reserves
- Invoice discounting/factoring
- Private equity funding
- Refinancing
- Asset-based lending
- Debt for equity swaps

Managing Cash Flow/Balance Sheet

Landlords, Key Suppliers and Other Creditors

Depending on the longer-term cash position of the company, negotiating a payment plan or asking for forbearance from landlords, suppliers and/or other creditors can provide a solution to temporary cash flow problems.

If a business is temporarily cash strapped, a short "breathing space" may enable the business to manage the position. However, directors will need to consider whether extending payment terms or agreeing a period of non-payment is the right thing to do. Informal arrangements can ease pressure, and may not need to be formally documented; however, if they only delay the problem then they might not be the optimum solution.

There are several ways to restructure payment obligations, for example:

- **Landlords** – Agreeing monthly instead of quarterly rent payments; re-negotiating rent; moving to a turnover rent; can the company negotiate a surrender of any leases if the company's real estate footprint has reduced?; or could it exit over rented premises and agree something at market rate?
- **Suppliers** – Renegotiating contract terms, agreeing a re-payment plan or having a longer time to pay.
- **Creditors** – Agreeing a repayment plan, compromising outstanding debts, or offering security or guarantees for payment.

HMRC

HMRC can be the largest creditor. If a business has accrued tax liabilities that it cannot pay on time, HMRC may agree a time to pay agreement. However, it is important for a business to engage early with HMRC if it requires HMRC support. Asking HMRC for time to pay can be a complex process and, therefore, involving advisors to ensure that the right information is submitted to HMRC and the process is correctly managed can be invaluable. See our guide to managing HMRC and TTP agreements.

Employees

- Can the business restructure/reduce its workforce and thereby reduce overheads? The employee needs of many businesses have changed as a consequence of the pandemic and continue to do so.
- If the business is overstaffed, then restructuring the workforce could provide a straightforward cash flow solution.
- (NB: You should take advice before steps are taken to restructure to ensure compliance with employment laws.)

Debts

- Ensuring that the business has robust credit control procedures in place will ensure that it keeps on top of delinquent debtors, recovers debt on time and can take swift action, if necessary.
- Keeping an eye on debtor days (are they slipping?), and checking credit ratings and how the company's debtors are performing, will help inform whether a company should take formal action to recover unpaid debts before the debt becomes a "bad" non-recoverable debt.
- Consider whether insurance against non-payment is an option, or whether there are guarantors from whom the businesses can recover payment? Or can the business request a guarantee to protect against a bad debt? Does it have or can it obtain security that it could enforce if the debt is unpaid?

Close Unviable Operations or Sell Loss-making Divisions

Is there one part of the business that is underperforming and having an adverse impact on otherwise profitable parts? A solution might be to close or sell that part of the business to ring fence and protect the rest.

Supply Chain Mapping

- Mapping supply chain (looking at the business' suppliers, their suppliers and so on) enables a business to identify risk areas that might impact the viability of its own business, and then enable it to devise a plan to manage/reduce risk.
- A plan could help manage supply shortages, surges in demand or something more unexpected (a global pandemic, for example).
- Consider such things as dual or local sourcing and auditing your own suppliers' financial health alongside reviewing supply contracts to ensure they contain adequate termination rights, allow the business to move suppliers or even provide for greater monitoring and reporting requirements.

Retention of Title (ROT)

Review contracts with key customers to ensure they contain a retention of title clause (and that it is incorporated into the contract). A good ROT provision can put the business in a strong position if customers do not pay to recover unpaid goods and re-sell them or, if the customer enters an insolvency process, an enforceable ROT usually puts the business into a better position to negotiate a payment with the insolvency practitioner.

Moratorium

- Although badged under the "insolvency" banner, a company does not have to be insolvent to benefit from a moratorium. This is a standalone procedure that gives a company a minimum 20-business-day breathing space from creditor pressure. The directors of the business remain in control of the company during the period of the moratorium, which could last up to 12 months.
- A moratorium could be used in situations where a company has a temporary cash flow problem and the business is waiting for a significant cash injection that will ease pressure, or to allow it time to consider other options (such as re-financing) or as a pre-cursor to a more formal process (see further below).

Finance

There are various options depending on the circumstances and needs of the company, although if the business is in distress, directors should consider these options in light of directors' duties and in conjunction with advisors.

Existing Lenders

There are a number of options that a business can explore with its existing lenders. Those might include increasing its existing facilities, extending overdrafts or extending payment terms, or agreeing a period of forbearance.

New Lenders

Refinancing could enable existing debt to be refinanced with more favourable terms, such as a lower interest rates or extensions on payment periods.

Additional Finance

The business may be able to raise additional funds against its assets by raising finance secured against stock, equipment, machinery, property, etc.

Similarly, the business could look to raise additional cash through private equity funding, loans from directors or third parties injecting funds into the business.

Part of the company's business or assets could also be sold to raise capital.

Some businesses could also benefit from debt factoring or invoice discounting.

In simple terms, debt factoring involves a business "selling" their invoices to a third party at a discounted rate. The factor will advance an initial cash payment to the business, and then collect the debt before accounting to the business for the balance of the invoice, less an agreed percentage for its collection fees. Invoice discounting is similar but often cheaper to arrange than factoring. The business will receive a cash payment against outstanding invoices, but the business will remain in control of debt collection. Although the business will receive less than the full invoiced amount, both types of finance enable a quick injection of cash into the business.

Formal Options

Insolvency is a last resort, but if efforts to stabilise the business and ensure its viability have not done that, or it is simply too late in the day to rescue the business, then directors are under a duty to consider whether the business should enter an insolvency process. The decision about which one should be made in conjunction with the company's advisors and an insolvency practitioner.

- Moratorium
- Company Voluntary Arrangement
- Administration
- Liquidation (Voluntary/Compulsory)
- Restructuring Plan
- Scheme of Arrangement

Moratorium

Although the moratorium (explained above) can be used as a standalone process, it may also be appropriate as a pre-cursor to any of the below processes.

Company Voluntary Arrangement (CVA)

A CVA is essentially a contract between a company and its creditors that can offer a flexible and tailored solution by enabling the company to propose a compromise or arrangement to all of its creditors that, if approved, will bind all creditors to its terms.

The directors remain in control of the company and are responsible for implementing the proposal. An insolvency practitioner will oversee the process to ensure that the company is complying with the terms of the proposal but directors make the day-to-day decisions. A typical CVA lasts for a period of three to five years.

More recently, it has been used as an effective way of restructuring lease portfolios.

Administration

Administration involves the appointment of insolvency practitioners, who will step in and take control of the company's business and assets. The primary objective of administration is to rescue the company as a going concern. Once administrators are appointed, the directors will no longer have a say in how the business is managed.

A sale of the business and assets will often occur on appointment, or shortly after, and existing management can, and often do, buy the business back from the appointed administrators. If a sale cannot be achieved, the business will cease operations and its assets will be sold.

Liquidation

There are two types of insolvent liquidation process: creditors' liquidation and voluntary liquidation.

A creditors' liquidation follows a creditor petitioning the court to wind up the company on the basis that the company is balance sheet insolvent or unable to pay its debts when they fall due. Whereas a company that goes into voluntary liquidation, does so following the directors deciding that it should be placed into liquidation.

Both types of liquidation are usually terminal, meaning the company will cease trading.

Restructuring Plan

A restructuring plan enables a company to enter into a compromise or arrangement with one or more creditors and/or its shareholders. It allows greater flexibility than a CVA or scheme of arrangement because it enables a company to cram up/cram down secured and dissenting creditors.

Unlike a CVA, a restructuring plan has to be sanctioned by the court following creditors voting on whether to approve the plan. Once approved, the company will implement the plan, which could include resetting covenants, rescheduling payments, debt for equity swaps or comprises of debt.

Scheme of Arrangement

This is similar to a restructuring plan – the primary difference between the two processes is that a scheme of arrangement does not allow cross-class cram down, but also there is no requirement for the company to be in financial difficulty.

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