August 2023

Newman & Partners

Licensed Insolvency Practitioners

RECOVERY & REVIVAL BULLETIN

Welcome to the latest issue of our Recovery and Revival Bulletin, designed to keep you up-to-date on insolvency matters that may be of interest to you. If you have any feedback on this bulletin, or would like to know more about our services or how we can help you, please contact us on **020 8357 2727** or at **insolvency@newmanandpartners.co.uk**

Are zombie firms facing extinction?

Zombie firms have been a part of the UK business landscape for many years, with many hanging on after the end of the last financial crisis, surviving the pandemic, and even managing the shock of the cost-of-living crisis. Like their namesake, they really are the living dead.

However, in light of the current, evolving financial landscape, there are some significant market trends and predictions that are likely to be relevant to you and your clients, especially those with considerable outstanding debts.

Impact of rising interest rates

The UK currently has numerous companies termed as “zombie” businesses. These are firms that, in essence, survive primarily due to the previously low borrowing costs, barely managing to service their existing debts. Insolvency experts predict that these zombie businesses may not endure the recent surge in interest rates.

In fact, they foresee a potential collapse of virtually all such companies within the next 18 months as they struggle even more to manage debt repayments. These firms have often been a drain on supply chains and the economy, as they fail to invest or improve productivity due to their indebtedness.

The insolvency landscape

Reflecting these concerns, recent data shows that company insolvencies in England and Wales are at a 24-year peak. A substantial 2,552 companies filed for insolvency in May 2023, marking a 40 per cent increase from the previous year. This number of insolvencies even surpasses the previous rates seen during the pandemic – although at the time businesses could benefit from the Government’s support measures.

As a result, many in insolvency practice are growing. Industry experts, including Russ Mould from stockbroker AJ Bell, point out that insolvency practitioners often experience growth during challenging economic times. Many companies are reaching a point where their cash flows are insufficient to service their debts, pushing them towards insolvency.

Which businesses are struggling the most?

While it’s essential to understand the broader economic picture, also note that smaller companies tend to be the earliest casualties in financial downturns. Currently, the focus is shifting to mid-market companies as they too begin to experience difficulties due to higher interest rates and inflation.

Conversely, firms like the UK’s largest pawnbroker, H&T, have experienced substantial growth due to the economic conditions, with gross lending rising 22 per cent in the last six months. Such trends indicate increased demand for short-term financial solutions and services, indicating a wider struggle throughout the UK economy.

As trusted advisers, it is important that you understand these trends and advise your clients, accordingly, ensuring that they are prepared for potential challenges and can navigate the shifting economic waters with prudence and insight. If you need any assistance with insolvency advice, please **speak to our team**.

Start-up failure rate at over 60 per cent - but why?

The UK's reputation as a leading global business epicentre for exciting start-ups is well known, especially within innovative industries. However, beneath the veneer of its thriving business ecosystem lies a challenging terrain, especially for Small and Medium Enterprises (SMEs) in their early stages.

An alarming statistic for accountants and their clients is the daunting 60 per cent start-up failure rate in the UK. As insolvency practitioners, we believe it's crucial to unpack this statistic, shed light on its underlying causes, and offer guidance on mitigating these risks.

Delving into the causes of startup failures

While multiple factors contribute to the challenges SMEs face, three main culprits stand out:

1. **Capital and cash flow dilemmas:** An SME's lifeblood is its capital and cash flow. A recent, Quickbooks' study underscores this, revealing that a staggering 65 per cent of failing SMEs attribute their downfall to cash flow complications. For many startups, financial missteps in the early stages can lead to insurmountable problems down the line.

2. **The Pitfalls of inadequate market research:** Recognising and catering to the target market's needs is the bedrock of any successful business venture. Unfortunately, many startups in the UK miss the mark. CBInsights highlights that 42 per cent of startups fold due to a sheer mismatch between their offerings and the market's actual demand. The lack of comprehensive market research often culminates in products or services that fail to resonate with their intended audience.

3. **Scaling-up struggles:** Expansion is a goal for many SMEs, but scaling a business isn't without its unique set of challenges. A Smith & Williamson survey paints a revealing picture: 39 per cent of UK businesses grapple with growth. These struggles often stem from operational bottlenecks, challenges in acquiring and retaining top talent, and systemic inefficiencies that become magnified as the business grows.

How accountants can help their start-up clients avoid failure:

- **Financial planning and management:** Ensure your clients have a clear financial roadmap. Periodic cash flow assessments, proactive financial risk assessments, and leveraging tools and technologies to maintain financial health can make a world of difference.

- **Market research:** Encourage SMEs to invest time and resources in thorough market research. Understanding the target demographic, their needs, preferences, and pain points can guide product development, marketing strategies, and business decisions.

- **Operational readiness for scaling:** As businesses grow, so do their challenges. Advise your clients to have robust processes in place, invest in training and development, and adopt technologies that streamline operations and support growth.

While the UK's start-up landscape offers immense potential, the path is fraught with challenges. Accountants, equipped with these insights, can play a pivotal role in guiding their clients through the maze of startup challenges, steering them towards sustainable success. If you require any assistance supporting up-and-coming businesses with their financial challenges, please **get in touch**.

Are tough economic conditions weakening UK business confidence?

The recent ICAEW Business Confidence Monitor (BCM) paints a picture of cautious optimism in the UK business sector, albeit with lingering concerns from the pandemic's aftermath. For accountants keen on understanding the market pulse to advise their clientele better, this report is invaluable.

A glimpse into business confidence

The UK's business outlook, while still on the rebound, lingers below the pre-pandemic norm. The Q2 2023 BCM, which polls 1,000 chartered accountants, registers a confidence index of 6.1. Although this is an uptick from Q1's 2.5, it's shy of the pre-pandemic 2010-2019 average of 7.2.

The study underscores the dent in business sentiment wrought by high inflation rates and consecutive interest rate hikes. ICAEW's Chief Executive, Michael Issa, reflecting on the findings, noted the decreased optimism among sectors like property and retail, where high interest rates are dampening spirits.

While the survey points to a general deceleration in domestic sales growth, the property sector emerges as particularly vulnerable. This downturn is attributed to factors like rising interest rates and a tepid housing market atmosphere. Meanwhile, the retail and wholesale sectors share similar sentiments, thanks to their sensitivity to increasing interest rates.

The property sector, however, faces another challenge — it reported one of the lowest domestic sales growth figures across all sectors. Such observations drive home the necessity for accountants to furnish clients in these sectors with strategies tailored to weather the storm.

Costs in focus

ICAEW's findings reveal that input prices have escalated at unprecedented rates since 2004, although a reprieve seems likely in the forthcoming year. This optimism stems from expected cost reductions in energy and raw materials. Meanwhile, the sales price growth has peaked in Q2, notably in manufacturing, retail, and wholesale. However, a cooldown is anticipated, mirroring the input cost slowdown.

Wages, especially in IT and communication companies, have reached unparalleled heights, signalling the sector's insatiable demand for skilled talent. ICAEW's Suren Thiru stresses the economic strains from rampant inflation, burgeoning wage costs, and interest rate spikes, foreseeing a challenging latter half of 2023.

Around 37 per cent of businesses grapple with evolving regulatory requirements, with sectors like retail and wholesale citing Brexit-related concerns. An ebbing customer demand, coupled with the recent corporation tax hike, further complicates the landscape for many businesses. For firms, especially in the property sector, issues like bank charges and capital accessibility loom large.

Capital investment expansion has decelerated, and the trend seems poised to continue, mirroring the fragile business sentiment. Issa emphasises the need for a robust governmental strategy to spur sustainable growth and bolster business confidence.

For accountants, the BCM findings underscore the volatile economic landscape. To better advise clients, especially SMEs, a deeper understanding of the prevailing challenges and potential solutions is crucial. Emphasising flexibility, exploring specialist lending solutions, and keeping abreast of economic trends can guide businesses through these uncertain times.

CAREFUL CONSIDERATION IS NEEDED BEFORE TAKING OUT ANY FORM OF FINANCE AND SPECIALIST ADVICE SHOULD BE SOUGHT. IF YOU HAVE ANY QUESTIONS, PLEASE CONTACT US.

Newman & Partners Insolvency
Lynwood House
373/375 Station Road
Harrow
Middlesex HA1 2AW

T: 020 8357 2727
F: 020 8357 2027

E: insolvency@newmanandpartners.co.uk
W: www.newmanandpartners.co.uk

Newman & Partners
Licensed Insolvency Practitioners

The matters discussed in this bulletin are by necessity brief and comprise summations and introductions to the subject referred to.
The content of this bulletin should not be considered by any reader to comprise full proper legal advice and should not be relied upon.