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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

Insolvency in the construction industry: Unpacking the 'domino effect'

The construction industry seems to be interconnected in ways that are not well understood. This is most observable when insolvency sweeps through the sector in a way that is as unique as it is disquieting.



Recent research by Ping Yung, Abdullahi B. Saka, and Sam Edward Caborn from Leeds Beckett University has sought to examine the 'domino effect' that has long been believed to exist in construction. Having considered the research, we now seek to break it down and outline how you can use the findings to guide your clients with their business practices.

What is the 'domino effect'?

As the construction sector is made up of intricate supply chains, insolvency can cause significant issues very swiftly. If one company that is part of a supply chain is insolvent, companies that rely upon the goods and services provided may struggle to continue. In turn, this could result in those companies becoming insolvent, and the cycle continues.

Conversely, a company that owes money to subcontractors and suppliers going insolvent leaves them with a sharp drop in revenue and thus jeopardises their own solvency. Yung, Saka, and Caborn found that "there is strong evidence on the existence of domino effects", thus showing that it is not a superstition but a measurable impact.

This is a continuation of findings from 1997 and 2010, showing that the domino effect has been a part of the construction industry for a long time. Interestingly, the number of people in the industry and the amount of lending were not found to be significant influences in the causes or consequences of the 'domino effect'. The significant factors were high unemployment rates and annual interest burdens. The impact of unemployment rates is likely due to a reduction in manpower, which in turn causes delays, missed payments, and subsequent financial struggles.

What can be done about the domino effect?

As harsh as it might sound, the biggest message coming from the research is that construction companies need to avoid becoming too reliant on other companies. Having a preferred supply is natural and something that they can continue doing.

However, if they want to escape the 'domino effect', it may be wise to have a few backup options. The 'domino effect' occurs because one business going insolvent sends a ripple through the sector as the loss of that company is felt.

By having a few alternatives to every step of their supply chain prepared in advance of any issues, they can avoid being dragged into the collapsing chain. Your clients will appreciate this advice when they are able to continue operating unimpeded as the rest of the sector struggles.

There is little that can be done to mitigate the impact of insolvency on unpaid bills, though, and advising businesses to have a range of financial avenues open could be necessary to protect them from this eventuality. Hopefully, research like this can be used to better chart the macroeconomic factors that drive sectoral insolvency.

Knowing the warning signs can, at the very least, help your clients make preparations for hardship and weather the oncoming storm.



Help your clients navigate the challenges of insolvency in the construction sector. ***Speak to our team today*** for tailored, expert advice.

A 'too big to fail' mindset is destroying higher education – what can businesses learn from this?

It is no real secret that banks are given special allowances by the Government to prevent them from becoming insolvent. Although the Government cannot incentivise banks to be reckless by giving them a permanent safety net, their value to society is such that they are seldom allowed to go fully insolvent. A similar situation may be emerging among the UK's universities. The Financial Times recently **published an article** outlining the ways that universities may be considered too big to fail. Yet, Baroness Jacqui Smith, the Minister for Higher Education, insisted recently that she would **allow universities to go bust "if necessary"**. Similar statements were made of Northern Rock shortly before it was bailed out by the Government during the 2008 financial crisis.

With two different business types, universities and banks, potentially too big to fail, what lessons can be taken from them and applied to businesses that are allowed to fail?

Why are universities struggling?

As many as half of the UK's universities are operating at a loss, with some approaching serious financial hardship. There is a genuine question surrounding the longevity of some universities. There have long been calls from universities to increase tuition fees, but this decision is out of their hands and is entirely controlled by the Government.

Recent controversies surrounding the wages and expenses of Vice Chancellors are likely also a contributing significant factor. The general wear and tear of hosting so many people seeking a brighter future also ensures that universities face steep maintenance and energy costs. A downturn in international students after the pandemic and Brexit are reducing a vital revenue stream as many universities historically charged higher fees for these students.

All of which serves to highlight the need for cash flow optimisation. Your clients will not have the luxury of being too big to fail, but the university example highlights the dangers of living on borrowed time. When it is not possible to increase prices, it becomes essential to diversify cash flow to compensate.

Businesses may mistake the generous repayment plans of student loans as a way to use credit control to boost customers at the cost of cash flow, but it is worth noting that universities do not bear the financial risk for student loans. The universities receive payment from the Treasury, and it is they who risk missing out on repayment when the loans get wiped after 40 years if not paid in full.

While businesses may be tempted to miss out on cash flow due to generous repayment plans in the service of goodwill, this can prevent growth and reduce the working capital that can be essential for adapting to changes in the economy.

Will universities begin to enter administration?

Much like banks, the collapse of a university would have a significant impact on wider society.

The legacy nature of student loans would be called into question should a university enter administration. Alumni may feel robbed and could perceive an insolvent university as a stain on their own academic legacy. As student loans can only be taken out once, would students in an insolvent university face any amount of compensation for the loss of their education?

More pressingly, there would be a question of who is ultimately responsible for the insolvency.

Whereas businesses have the opportunity to control their own finances, it is the Government who have the final say over university tuition fees. Similarly, some of the loss of international students is attributable to Government policy and messaging. As many would see the financial struggles as being partly caused by the Government, the question would be raised about the extent to which the Government should resolve them. If a university could prove that the Government caused its insolvency, which would be possible given the stipulations on tuition fees, then a bailout could be required.

Undeniably, there is a disconnect between universities that are struggling financially and those that are not. Reputation plays a significant part in this, with the Russell Group universities finding themselves able to generate enough income to compensate for downturns in the market. These universities also have assets that can be leveraged to raise additional funds. Universities that strategically use the spaces they have available to them could begin to access alternative revenues not beholden to Government interference. It is likely a desire for innovative remedies to financial hardship that Baroness Smith was pushing for with her bold statement.

The takeaway lesson from the university situation is one of cost management. The successful universities are those that do not wait for finances to become available but actively seek out ways to stay operational. Managing the salaries and expenses of executives is also an essential part of keeping any enterprise functioning and growing. The slight drop in university attendance cannot account for the financial struggles that many institutions face. Poor management seems to be playing a part, and that is the real noteworthy aspect of the situation.

Your client's business may not be considered too big to fail, but they can learn lessons from those that are. Complacency is at odds with success, and your client should be actively seeking new financial avenues to prepare for any changes in the market.

Insolvency cannot always be avoided, but a business can mitigate risks by keeping costs low and insisting on timely payments from customers. Cash flow is key to staving off insolvency, and being able to demonstrate realistic plans for securing more working capital may enable your client to keep going even if debts are beginning to build.



For tailored, expert advice about insolvency, **Speak to our team today.**



When should businesses fight off insolvency, and when should they just accept it?

No business wants to face the prospect of insolvency, and it can be an emotionally charged time when it does happen. Some might see it as a sign of failure, when the reality is often more nuanced and connected to wider economic factors. Although there may be an instinct to fight insolvency to try to save a business, this is not always the best thing to do.

By understanding the responsibilities of company directors, you can better advise your clients on when to fight insolvency and when to let it happen.

When should a business fight insolvency?

If a business is facing insolvency, it is due to its liabilities vastly outweighing its recoverable assets. Debtors will be waiting for their payments, and, in all likelihood, interest in the debts will steadily increase until they can be resolved. In this situation, your client may come to you seeking guidance on how to proceed.

How you advise your client at this critical moment matters, as the decisions they make will determine whether they face legal repercussions. Drawing up a business plan with realistic projections will help determine whether the business can be pulled back from the brink.

Exploring any previously unused avenues of finance is wise, as there may be grants, loans, or reliefs available to your client that will be essential in knowing whether they can fight insolvency.

With accurate forecasting, it is possible to predict whether debts have a reasonable chance of being settled. If your client does plan to fight insolvency, they will need to prove that this outlook was feasible at the time the decision was made, even if it does not ultimately come to fruition.

If insolvency is successfully fought and the debts are settled, your client will require advice to avoid a similar situation in the future. Optimising their cash flow and keeping a tighter focus on their business plan can be ways to mitigate the threat of insolvency.

When is it not worth fighting insolvency?

Insolvency is sometimes a necessary outcome for a business in financial difficulty. When a business's liabilities vastly outweigh its recoverable assets, then there is no cause to fight insolvency, and it should be accepted.

To continue to fight insolvency when all hope is lost is illegal, as it could be considered wrongful trading. If a director continues trading when there is no reasonable prospect of avoiding an insolvency procedure, then they can be held legally responsible for this. This is because of the wider risk it puts on other businesses, who may find themselves not getting paid as the indebted company continues to struggle.



It is neither noble nor valiant to fight insolvency at this point and is instead simply reckless.

Insolvency as a process is designed to make the unfortunate collapse of a business as manageable as possible for all affected parties. We provide specialist advice to ensure that you can guide your client through the specifics of their situation. Our experts understand the insolvency process and can help determine when it is a necessary course of action.



If you or a client is unsure about insolvency, **Speak to our team today** for tailored, expert advice.

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.

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