

# Providing Support to Companies in Financial Distress

## *A Practical Guide*

**ArmstrongWatson<sup>®</sup>**

Accountants, Business & Financial Advisers

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The Coronavirus pandemic has left many businesses with reduced turnover and deferred liabilities. Providing guidance to these businesses will be important in ensuring that they can return to profitability in due course. There are some red flags that generally indicate that the business may be in need of assistance.

#### ⚠️ Key Warning Signs

- Extended borrowing or unauthorised overdrafts
- Requests for help to access short term finance
- Overtrading
- Difficulty meeting payments when they fall due
- Crown arrears
- Creditors threatening action
- Key management resigning
- Business making losses historically
- Unable or unsuccessful in applying for Government-backed loans

Cash flow difficulties can often manifest themselves in businesses needing extended credit lines (either from their lender or from suppliers). If a business is struggling, its bank will often agree a temporary overdraft or, in the case of an invoice discount provider, will provide an extension to their drawdown, allowing the business to access cash over and above its agreed limit.

Unless the cashflow challenges are known to be purely short term, this can be an indicator of distress within the business.

[See: Understanding your financial position](#)

If a business owner is looking for assistance in obtaining short term finance, this can be an indicator that the business has cashflow issues. Unsecured loans are easy to obtain on the internet and can be the easiest way of bridging a short term cash need in the business. However, short term finance can be expensive and the interest costs can add stress to an already tight cashflow.

In addition, many unsecured loans require personal guarantees from the directors – if the business is distressed, there is an increased chance that the director will become liable for the debt.

[See: Understanding your personal liabilities in relation to company debt](#)

Overtrading occurs when a company takes on new orders without having the resources to fulfil them, for example if staff numbers are short, or there has been insufficient investment in equipment to complete an order. Cash flow is often stretched beyond breaking point at these times, and the company begins a decline before they are paid by their customer. This can often prove fatal for a business.

The key here is that growth needs to be sustainable. Where businesses have been closed for a period and turnover is reduced, business owners will be keen to get their business back on track as soon as possible, which makes them susceptible to overtrading.

[See: Avoiding the risk of overtrading](#)

Increasing liabilities is often a common indicator of financial distress as it suggests that creditors are not able to be paid on time. If a business is unable to pay its debts as and when they fall due, it is technically insolvent (per the Insolvency Act 1986) as this is one of the definitions of insolvency.

Owing money to HM Revenue & Customs, having suppliers on stop (and therefore refusing to supply), and creditors threatening legal action are all indicators that a business is in financial distress as it has not been able to keep up to date with its obligations.

If a business is potentially insolvent, directors have additional duties of which they should be aware, and it is vital that they seek advice as soon as possible. Unfortunately, many directors think that resigning is the best option in these circumstances, which can lead to key management leaving the business, but this is not always the answer.

[See: Directors' duties in uncertain times](#)

## *Being in financial distress does not have to be terminal*

There are many different options available to business owners in these challenging times, however the sooner advice is sought, the more options that will be available. Very often, business owners are completely overwhelmed by the situation in which they find themselves, but by speaking to someone independent, it can help them process the situation.

[See: Mitigating director fatigue](#)

If you need further assistance with the various restructuring and insolvency options available, please visit our website or get in touch with our key contacts, who will be happy to help.



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