INSOLVENCY INSIGHTS

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creditorservices@menzies.co.uk
menzies.co.uk/creditor-services

EDITION 2

WELCOME TO THE SECOND EDITION OF OUR INSOLVENCY INSIGHTS MAGAZINE!

Insolvencies are on the rise, with the levels of winding up petitions continuing to increase as businesses are hit by high interest rates, a decline in consumer spending and the withdrawal of covid support measures. At the time of writing, corporate insolvencies are back higher than pre-pandemic levels so it's now more important than ever for credit professionals to be able to spot the warning signs early and understand how you can maximise your recoveries if faced with an insolvent customer.

In this edition of Insolvency Insights, we explain how investigations carried out by Insolvency Practitioners can bring rewards for creditors and debate whether Personal Guarantees offer any real protection – is a Personal Guarantee Register needed?

We also take the opportunity to speak to Charles Mayhew, Director at Global Credit Recoveries, to discuss the current international collections landscape, the challenges ahead and the risks of doing business in emerging markets within the EMEA region.

We hope you find this resource useful. If, upon reading, you have any insolvency related questions or wish to discuss your specific circumstances, please let us know.

Additionally, if you'd like to collaborate or be featured in an upcoming edition, please do reach out – we'd love to hear from you.

Giuseppe Parla
Director at Menzies LLP
gparla@menzies.co.uk
+44 (0)20 7465 1919

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INSIDE THIS EDITION:

NEW

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When will I get paid?
The options available to you when debt is outstanding

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menzies.co.uk/podcast

PERSONAL GUARANTEES:

DO THEY OFFER ANY REAL PROTECTION?

Some credit managers will be familiar with the practice of seeking personal guarantees (PGs) from Directors to support credit extended to limited companies, but how much protection do they really provide?

PG stacking: a risk factor

The risk of a PG being of limited value increases when Directors provide multiple PGs (known as PG stacking), and their personal assets are not sufficient to cover the debts. Having a PG does not grant you any priority: whether you were the first or last to obtain the PG, you will be one of the Director's unsecured creditors.

> **An article from the Purbeck PG Insurance Monitor shows that demand for insurance cover to protect Directors from claims against their personal wealth and assets increased sharply in 2023: up 93% year on year.**

This suggests that Directors have become more concerned about a call being made on their PGs.

Managing risk

When managing multiple credit lines, it is important for credit managers to stay alert to any signs that the risk profile of a customer might be changing. This can be achieved through regular communication and by discussing any issues they might be experiencing. Sector-specific market intelligence can also help to flag any potential issues at an early stage, but there is not always transparency in a director's finances. Often if a director's company were to fail, then their personal financial circumstances are likely to deteriorate as well.

One simple step that credit managers can take to assess the value of seeking a PG, or assessing an existing one, is to undertake a land registry search, as a PG backed up by a charge over a property is usually considered as a stronger form of assurance. Other steps could be to request HMRC and payroll information from the Director.

When considering making a call on a guarantor to enforce the payment under the PG, it is important to understand 1) if the PG is unlimited or limited to a specific amount and 2) what the payment terms are? Failing to make a payment under the terms of the PG could lead to a petition for an individual's bankruptcy. You should seek legal advice before proceeding as a PG should only be provided by a 'competent' person. A claim against an individual in a bankruptcy would be ranked as an unsecured creditor. One of the reasons you may want to pursue this route of bankruptcy is if an individual was putting assets beyond the reach of creditors. Otherwise, you could be throwing more good money after bad.

Calls for a Register

The credit management industry has been calling for protection against the misuse of PGs for some time. Establishing a Register and making PGs a matter of public record could be an effective solution. But who would own and run the Register? And would it be mandatory? There have been many suggestions about how it might work, but ultimately the UK Government will need to decide what action to take. The credit industry will have to watch and wait, but in the meantime, we could be sat on a mountain of worthless PGs.

Giuseppe Parla
Director
gparla@menzies.co.uk
+44 (0)20 7465 1919

MORE CREDIT, WHAT'S THE RISK?

Managing cash is important for any business, but what happens if customers need to extend their credit terms beyond those already agreed and what are the risks of doing so?

Offering credit terms to support sales is a normal and expected part of doing business in many sectors. However, there may be times when business owners come under pressure to extend credit terms beyond pre-agreed limits. Whilst this could happen for a number of reasons, how should they respond?

Customers may ask to extend the terms of their credit agreement for a variety of reasons. For example, they may be looking to extend the length of time before making payment, or the amount of credit they can accumulate. In either case, this could be a sign that they are experiencing cashflow difficulties and business owners need to be aware of this risk. Therefore, understanding the reason for the customer's request is crucial in order to balance the potential risks and rewards.

The main risk is non-payment; the larger the amount owed, or the length of term agreed, the greater risk the business is exposed to. However, working with a key customer can also bring benefits. For example, if the business agrees to increase credit terms, the customer may increase the volume of orders, which could in turn boost turnover and help the business to grow.

Before making a decision, owners should consider what's right for their business. Financial information, such as cashflow forecasts and aged debtor and creditor ledgers, can help to reveal whether the business can afford to negotiate increased credit agreements. Looking at the amount of time the business takes on average to collect payments, versus how long it takes to pay its creditors, can be a good indicator of whether the right balance in terms of risk and reward is being achieved.

If the business is making payments more quickly than it is collecting them, then it runs the risk of cashflow turning negative, therefore owners and directors should consider how this might be perceived externally. For example, banks and other investors may be more inclined to partner with a business that has good control of its cash.

There will always be positives and negatives and you should weigh up customer requests carefully before agreeing to any extended credit terms to make sure you aren't caught out by poor cashflow management.

Bethan Evans
Partner
bevans@menzies.co.uk
+44 (0)29 2044 7512

POWERS TO INVESTIGATE CAN BRING REWARDS

The first sign that a business is struggling could be as simple as a late payment or a request for longer payment terms. It could also indicate that the company is about to enter insolvency.

In some instances, you may be left with an unpaid invoice and feel powerless to do much about it. However, seeking advice from an Insolvency Practitioner (IP) could provide insight into what has happened within the business, and potentially recover some of the money owed.

An IP is appointed as the 'office holder' when a company enters administration or liquidation, with one of their roles being to investigate the demise of the company and the directors' conduct. Whilst the outcome of the investigation is confidential, it could give rise to potential claims and a recovery for the insolvent estate.

It is not unusual for IPs to find some evidence of misconduct by former directors of the insolvent business. For example, literally hundreds of directors have faced sanctions for 'Covid fraud' for abuse of the pandemic financial support schemes. Other examples of misconduct include deliberate attempts to 'hide or dispose of assets' to avoid paying creditors or to put certain creditors in a better position than others.

In the majority of cases, claims are pursued through the civil courts. There are a number of reasons for this, including that there is a lower burden of proof, so the claim is more likely to achieve a successful outcome. However, where evidence of criminal activity is found, claims against the individual involved can be brought through the criminal justice system.

Office holders may be subject to time constraints for pursuing these types of claims. For example, the Limitation Act 1980 sets out a time frame for bringing claims, which usually starts from the date the company entered administration or liquidation. In cases where there is evidence of fraud or deliberate concealment, the limitation period may be extended or removed altogether.

When faced with a customer struggling to pay outstanding invoices, it is important to be proactive and take prompt action to recover any money owed.

The investigations carried out by IPs can bring rewards for creditors and it can be fruitful to seek advice when there is potential wrong-doing. In many instances, businesses should err on the side of taking action rather than doing nothing, as there is often an opportunity to recover some of the monies owed. If evidence of fraud or misconduct is found, they will also be doing their bit to bring those responsible for wrong-doing to justice.

Alexandra Davies
Senior Manager
adavies@menzies.co.uk
+44 (0)29 2044 7511

ASK THE CREDIT EXPERT

> One piece of advice that will always ring true is that 'companies owe money, but people pay bills.' At the end of the day, our business is as much about relationships as it is about the detail, and a combination of both will achieve the best outcome for clients.

CHARLES MAYHEW
Director at Global Credit Recoveries
globalcreditrecoveries.com

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We've been speaking with Charles Mayhew, Director at Global Credit Recoveries, about international collections and here's what we found out.

GLOBAL
CREDIT RECOVERIES

How did you come to work within international collections?

I took a job opportunity in 1993, originally to work and live in Beijing. At the last minute, the opportunity changed, and my family and I ended up in Abu Dhabi. This was my first experience of working in the United Arab Emirates (UAE), and one that I seized with both hands, making some great contacts and building strong relationships. On my return to the UK, I took a job as sales and marketing director for an international debt recovery firm, and almost fell into credit management and international debt collection by accident as I found that I was able to use my experience and contacts from living abroad. I then went on to set up Morton Smith, which we grew to just shy of 100 employees. I had previously also set up Global Credit Recoveries, which I reignited with my son and business partner Joshua in 2018, and am very proud of the reputation we have built as an award-winning firm.

How challenging can international collections be for businesses?

When businesses look to expand their markets and export overseas, they take on a lot more risk, particularly in emerging markets. However, for those that are successful, the EMEA region is an area of incredible opportunity. Naturally, we get involved when things don't quite go to plan, as businesses often believe that international collections are similar to the UK, when in reality the process can be more expensive and last longer.

Businesses of different sizes also face different challenges. Larger businesses often outsource collections, which may mean only a basic process is followed. The outsourcer may not have the time required to call or make doorstep collections, which means that debt can stay sitting in one place unless a professional service is called in. Smaller businesses may experience different challenges, such as cash flow difficulties if they haven't received payment for a product or service.

Businesses of all sizes need a credit management team with the right mix of regional contacts and knowledge to expedite the collection process, whilst providing realistic timeframes and a clear view of potential challenges. For example, in some countries it is relatively simple to obtain a judgement, but enforcing the ruling could be more problematic. Having a collection team with a local presence also ensures that difficulties including time differences and language barriers can be overcome, and they will bring a specialist knowledge of the region's legal system.

For credit managers, what are the risks of doing business in emerging markets within the EMEA region?

Some of the risks are similar to working in the UK, including the risk of insolvency or the risk of not getting enough accurate information on debtors upfront. Credit managers working in international collections should also be aware that instances of fraud are on the rise. When looking for signs of fraud, an old industry adage is to look for the three F's – fountains, flag poles and fish tanks. It might seem facetious, but spotting these signs while visiting a premises could provide a clue as to whether the business is overspending or potentially doing things that it shouldn't.

What do credit managers who are keen to gain skills in this area need to know?

The most important thing to do is to network and build your base of contacts. Ours is a very open industry, with lots of people willing to share their knowledge, whether that is through forums such as the Chartered Institute of Credit Management, international forums or even through LinkedIn. Skills such as a second language are always a bonus, but not a necessity – it is more important by far to get to grips with the fundamentals of your role and be open to learning new things. No two countries operate the same way – so terms and conditions and rules of enforcement may differ. Credit managers have to be accurate and adaptable to get the best results.

If you would like to contribute to a future edition of Insolvency Insights, please get in touch as we would love to hear from you!

PRE-PACKAGED ADMINISTRATIONS: HOW TO PROTECT AGAINST A SECOND LOSS

It can be concerning when a company that owes you money is placed into Administration. But receiving a proposal explaining that a pre-packaged sale of the customer's business has taken place raises the question; should they continue trading with the new entity?

Trade creditors usually find out that a customer has entered into Administration upon receiving a letter and set of proposals. If the insolvent business has completed a pre-packaged sale, with the same director at the helm of the new company, creditors should receive a detailed explanation, including why this course of action has been taken, within a week of the commencement of the Administration.

Proposals should be considered with care

Proposals should provide a detailed explanation justifying why the pre-packaged sale was undertaken and why alternatives were not appropriate. They should contain information about the marketing campaign conducted and the sale price achieved. If a previously connected party has purchased the insolvent company out of Administration, the Administrator must include Statement of Insolvency Practice's (SIP) 16 disclosures, providing further details of why the business has been sold to them.

Creditors deciding whether to continue trading with the new company and on what terms, can present a genuine dilemma. There could be an opportunity to protect future revenues by continuing trade with the new entity, if creditors are willing to cut their losses and accept that existing debts may never be paid in full. However, there's always the risk that the new entity could fail again, driving up losses even further.

Steps to avoid a second loss

Creditors looking to continue trade with a new company, could ask the director for a personal guarantee, which would allow them to pursue the director personally for any money owed if the new company were also placed into an insolvency process.

To avoid outstanding invoices and giving credit to the new company, creditors could consider requesting payment on delivery. They could also consider reducing the payment terms, so that the new company pays all outstanding invoices within a shorter period than usual credit terms give. Consequently, if reduced payment terms are not met, the account can be placed on hold, mitigating the risk of substantial outstanding sums being owed.

To conclude, customers being involved in a pre-packaged Administration, doesn't have to lead to the termination of trading relationships. Taking necessary precautions and seeking reassurances that the new company is doing things differently makes it possible to protect future revenues and mitigate the risk of a second loss.

Alexandra Davies
Senior Manager
adavies@menzies.co.uk
+44 (0)29 2044 7511

CREDIT AWARD WINNERS!

The Menzies Creditor Services team were thrilled to be named as the winner of the Corporate Restructuring & Insolvency Team of the Year award at the Credit Awards 2023 – **for the third consecutive year!**

The Credit Awards is a flagship event in the credit and financial services industry, designed to recognise and celebrate innovation, best practice and the hard work of individuals, business divisions and pan-global conglomerates across the entire industry.

> *We are delighted and very proud to have been awarded 'Corporate Restructuring & Insolvency Team of the Year' for a remarkable third consecutive year. It is extremely gratifying to see that all the commitment and dedication that our Creditor Services team put into their work is being recognised. We will continue to work alongside the credit industry, especially as a corporate partner of the Chartered Institute of Credit Management (CICM), supporting the industry with our knowledge and expertise.*

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MEET THE EXPERTS

The Menzies Creditor Services team can advise on the best way for you to protect your position when one of your debtors enters, or is approaching, insolvency proceedings. Utilising our extensive experience and expert insights, we work in collaboration with you, drawing upon our industry and insolvency sector knowledge, to improve your financial outcome.

For further information on our creditor services offering, please get in touch.

BETHAN EVANS
PARTNER
bevans@menzies.co.uk
+44 (0)29 2044 7512

SIMON UNDERWOOD
PARTNER
sunderwood@menzies.co.uk
+44 (0)20 7465 1932

GIUSEPPE PARLA
DIRECTOR
gparla@menzies.co.uk
+44 (0)20 7465 1919

ALEXANDRA DAVIES
SENIOR MANAGER
adavies@menzies.co.uk
+44 (0)29 2044 7511

LIAM JONES
SENIOR ADMINISTRATOR
ljones@menzies.co.uk
+44 (0)3309 129 186

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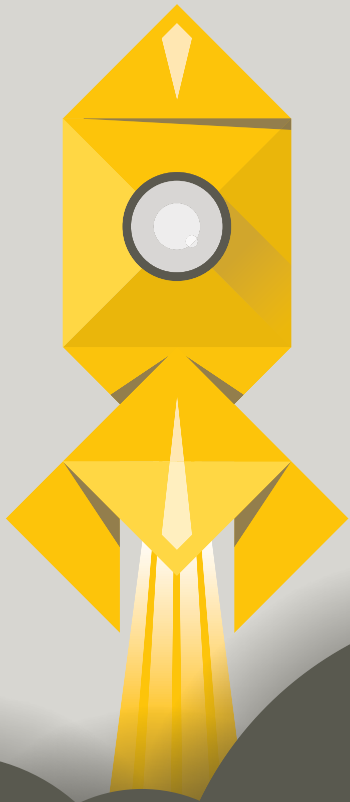

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