

OVERTRADING

Overtrading is a term used for companies trading whilst under-capitalised. Often people refer to overtrading as a concern for new companies. It can also apply to established companies emerging from difficult times, when order levels increase comparatively suddenly.

Under-capitalisation could be cured by new investors or borrowings, but raising finance is not necessarily straight forward or cheap. In essence the problem is that a company's working capital has been eroded during the recession and although balance sheet solvent its current assets are less than its current liabilities. So when an increase in turnover occurs the required funding to cover employee costs, transport, suppliers etc. is not readily available.

The stresses on short term cash, especially with already stretched relationships with suppliers, can be difficult to manage. Newer companies are often able to adapt more quickly, however they could face other risks due to their lack of track record. It is even harder to manage the financial stresses when change is required in an established business. Most businesses know how difficult it is to manage change, but for established businesses the implementation of, for example, lean techniques whilst trying to (re)grow the business requires time and effort to change current practices.

In difficult financial times the problem for businesses is not helped if it involves the necessary cost of employing outside consultants to come in to assist in managing change.

We are all hopeful that the recessionary times we are in will end shortly. Obviously as Insolvency Practitioners our experience is that a number of companies will fail due to an inability to trade out of their current predicament. It has been said that the three causes of insolvency are management, management, and management, i.e. most eventualities can be managed. Established companies who have started to look at the longer term may have reviewed their working capital requirements and looked at managing the risks they face for survival. In some cases this could be managed involving formal insolvency procedures such as Voluntary Arrangements and pre-pack Administrations.

The term zombie companies has often been used for companies unable to do much more than survive, unfortunately for them when we do emerge from recession it is less likely that their business will be able to compete and 'trade-out' without some form of insolvency. For them the timing of a restructuring through an insolvency procedure could be vital.

Please note that should your clients require any confidential advice regarding the above or any other insolvency matter they are welcome to contact one of our Partners. Initial advice is provided free of charge and without obligation. Also, if you or any of your colleagues require any clarification regarding insolvency law or procedure, please do not hesitate to contact us.