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Glimpses of optimism emerge but the spectre of debt remains

Parts of the financial services sector expect business volumes to rise over the next quarter for the first time in nearly two years.

There is also some optimism about the overall business situation but rising debt levels remain a constant worry. These are some of the findings in the latest Financial Services Survey carried out by the Confederation of British Industry (CBI) and Pricewaterhouse Coopers (PwC).

The figures show that while firms saw their income and profitability continue to fall in the three months to June, the pace of decline was much slower than in the previous quarter. When asked about their business volumes in the quarter to June, 22% reported an increase and 50% said they declined giving a balance of -28%.

This was a significant improvement on the previous quarter which returned a figure of -47%. It is also the slowest rate

of decline since volumes first began to fall in 2007.

There were similar findings when firms were asked about their profitability. Of those questioned, 27% saw profits rise and 51% reported a fall, giving a balance of -24%. This compared with -47% in the previous quarter. The survey suggests the rate of decline will fall further in the next quarter to -17%.

The findings suggest that the industry may be starting the process of recovery although the outlook varies from sector to sector. Banks, insurance companies and

building societies expect volumes to rise and profitability to stabilise over the coming quarter.

However, securities traders and investment managers believe the improvement will only be temporary and they expect further declines in volume to return next quarter.

Debt remains a problem across all sectors. The volume of bad debts rose at the sharpest rate (+51%) since the survey began in 1989 and a similar increase of +50% is expected in the next quarter.



Commenting on the findings, the CBI's Chief Economic Adviser, Ian McCafferty said: "Conditions remain challenging. Although demand looks like it is beginning to recover, it is doing so from a very low base. We can still expect lower profitability, significant job losses and cuts to investment in the coming months."

While it is encouraging to see some signs of optimism, the concerns about debt remain and emphasise the need for all firms to keep a tight control on their cash flow.

Pre-pack administrations can 'save jobs and help creditors'

Research by the insolvency trade body R3 has found that nearly 5,000 British jobs have been saved this year by the use of pre-packaged administrations.

The survey covered 89 pre-pack cases in which 88% of the jobs at risk were eventually saved.

Under the pre-pack system, a buyer is lined up before the company actually goes into administration. Pre-packs tend to be used when swift action is needed because of particular commercial pressures.

New regulations came into force on the 1st of January obliging administrators to reveal to creditors the name of the buyer and the price paid for the failing company. They must also reveal information about the relationship between the buyer and former directors or shareholders.

R3, which represents 97% of UK insolvency practitioners, said the key reasons cited by its members for



undertaking a pre-pack included the chance to avoid liquidation and the need for a fast sale to prevent rumours of financial difficulties which could destroy what remained of the business.

An R3 spokesman said: "They are a misunderstood insolvency tool, the benefits of which are frequently lost in the debate over their perceived impact on creditors. However, independent research shows that pre-packs fare considerably better than alternatives in terms of the retention of jobs and returns to secured creditors.

"I would therefore urge creditors and the public to give greater recognition to the role of pre-packs in saving jobs and achieving returns for creditors."

Where next



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Courts could be swamped by surge of debt cases

UK companies are stepping up their approach to dealing with bad debts, according to a new survey by the business information provider, Creditsafe.

Its research shows that one in four businesses intend to take legal action over the coming year to enforce the recovery of outstanding debts. The tougher approach comes as six out of 10 businesses believe they will have to contend with an increase in defaulted payments for the rest of this year.

The survey also revealed that one in five businesses intend to introduce more stringent penalties for late payment. In some cases, this will involve charging



interest at 100%. The Creditsafe research discovered that a television production agency has modified its terms and conditions to allow it to charge 100% interest on invoices not paid within its 30 day settlement period. The marketing director at Creditsafe, David Knowles, said: "While enforcement of contractual penalties used to be a last resort,

increasingly companies are embracing legal action as soon as payments slip beyond the timeframe set out in their terms and conditions.

"We could see the courts increasingly overburdened with claims and increasing numbers of involuntary insolvencies as firms demand immediate payment of outstanding invoices."

The survey confirms that more and more businesses are prepared to take action to protect their liquidity position and, of course, it is the firms who are the most proactive who are the ones most likely to recover money owed to them. Firms who sit back and wait are the ones most likely to lose out.

Pressure on banking system eases but problems remain

Both sentiment and funding conditions have improved recently in the banking sector, according to the latest Financial Stability Report by the Bank of England.

However, there are still problems to be addressed and banks remain vulnerable.

Leverage is still high and so banks in the UK and throughout the rest of the world remain sensitive to adverse economic or financial developments which could affect recovery. The report highlights five key areas where policy changes

are needed to ensure stability in the financial system. The first is the need to strengthen market discipline. The banks should have to make more public disclosures, and in order to control risk taking, financial institutions must face a credible threat of closure.

The second area that should be addressed is the need for financial institutions to provide greater self-insurance. This would require "higher levels of loss-absorbing bank capital and larger, high-quality liquidity buffers;



a cushion to be built up to absorb future losses during the upswing of a cycle; reduced reliance on ratings agencies; contingency plans for accessing capital and funding in times of stress, and for restructuring or winding up an institution in the event of distress".

The report also calls for improved management of risks arising from interactions among financial institutions and for the size and structure of the financial system to be compatible with maintaining stability. "Banks should not be too big or complex. Authorities, domestically and internationally, should consider whether they need more actively to influence or constrain the future size and structure of the system to support stability."

Paul Tucker – Deputy Governor, Financial Stability – said: "The policy debate now underway matters enormously if we are to achieve a more stable financial system in the future. No particular initiative will be sufficient by itself."

No return to growth until next year

The Confederation of British Industry (CBI) says the economy is now stabilising but predicts that there will be no real recovery until next year.

The CBI believes the worst of the quarterly falls in GDP are now behind us and that, with the support of low interest rates and quantitative easing, those falls should flatten out in the second half of this year.

We can expect modest growth to resume during the first three months of 2010.

Richard Lambert, CBI Director-General said: "Some commentators have been carried away by recent tentative indicators as evidence of 'green

shoots'. It will take some time before we can be sure these shoots have roots we can depend on for sustainable growth and, in the meantime, the government must do everything it can to help firms get access to credit."

Business investment is expected to shrink by 12.4% this year and by a further 1.4% in 2010. Overall household consumption is expected to fall by 2.9% for 2009 and grow only modestly by 0.5% next year.

The CBI expects that the economy will have shrunk by a cumulative 4.8% by the end of the recession after five consecutive quarterly falls in GDP. That may seem bad but it is not as severe as the 5.9% fall seen in the early 1980s.