

switched to demanding annual price savings of 5 per cent or more. Tier 1 suppliers, anxious for volume growth, with little thought about margins, started to buy each other to gain scale. Many of these acquisitions, however, have failed to deliver expectations.

The squeeze on margins has now cascaded down to the tier 2 suppliers who are suffering. They are not generally strong enough, either structurally or financially, to support such margin pressures for long. They often do not have sufficient headroom and cannot manage the move to a lower cost environment.

'Businesses need to be supported by a robust system of supply chain management...'

Today there are a number of major tier 1 suppliers and a larger number of tier 2 suppliers who are in financial difficulties. Turnaround strategies for these companies should major on returning them to their core competences and focus on margin management and market leadership. Businesses need to be supported by a robust system of supply chain management with access to lower cost component supply or the ability to transfer low value added products into low cost manufacturing areas. This is most likely to be achieved through joint venture or technical licensing agreements with local partners. Companies should also be considering both consolidation and reverse engineering opportunities. The skill base and product technology in the UK has value to a component supplier in Eastern Europe, Asia or South America who has low costs but lacks technology and international exposure. Technological change is driving the automotive industry as never before. However, this could well be storing up further problems, particularly in the fast accelerating electronics sector. R&D budgets here are in some cases exceeding 30 per cent of annual sales revenues, almost five times the level of leading tier 1 suppliers. This level of spend on a recurring basis is unsustainable and could be a pointer to problems down the road.

Simon Paul
is a senior manager
in the Kroll Industry
Group.



The Enterprise Act – a brave new world?

Thoughts from Keith Bordell of Travers Smith Braithwaite on how the introduction of the Enterprise Act – and the move towards a more debtor-friendly environment – might encourage the use of turnaround professionals.

Survival of the company

A significant change in the Enterprise Act is that an administrators' first aim, wherever practical, will be to try to save the company itself and not just its business. The switch in emphasis from the appointment of administrative receivers (whose primary aim is to realise assets for the benefit of the appointing charge-holder) to an administrator whose first aim will be to save the company itself, may well encourage charge-holders and other stakeholders to look more closely at steps that can be taken prior to a formal insolvency procedure to rescue the company (or to try to get it re-banked!).

Also, as companies and directors become aware of the Enterprise Act and its consequences, they may feel less afraid than previously to notify bankers, shareholders, advisers of problems if they think a plan can be formulated to work these out. Turnaround professionals may obviously be engaged to assist in the process.

Preferential creditors

The Act will introduce legislation whereby the crown loses its preferential status in an insolvency. A new system is being introduced so that a percentage of floating charge realisations (basically stock and other changing classes of assets) will be made available for unsecured creditors. Under the system, after the first £10,000, 20 per cent of floating charge realisations will be distributed pari passu amongst unsecured creditors up to a set maxim.

At present, charge-holders are often reluctant to place significant value on floating charge assets as preferential creditors may be entitled to most if not all of these realisations. Under the new proposals, whilst certain preferential creditors (eg employees) will remain, the replacement of Crown preference with a set percentage available for unsecured creditors may, in appropriate cases, mean that charge-holders feel able to place a higher valuation on floating charge assets, thereby making them more amenable to providing new money to the company. It should be noted that this change will only apply to

companies which have granted 'new' (ie post-Enterprise Act) floating charges and the flip side of the coin is that because of their greater exposure under the new regime, Crown departments may in future cut less slack to companies which fall behind with payments.

Debtor in possession?

In some situations an administration petition may be unavoidable – especially if the company requires the protection of a moratorium. In such situations there may be arguments in favour of the increased use of protocols between incumbent management (which may include a turnaround practitioner) and the administrator. This would move the UK closer to a US debtor-in-possession model with management remaining in place and the administrator adopting more of a supervisory and monitoring role. Whilst such protocols have already been used in a small number of cases under the existing insolvency legislation, the Enterprise Act provides statutory support for prioritising the interests of the company, its creditors, shareholders and other stakeholders.

Conclusion

Once it beds in, the Enterprise Act should be good news for turnaround professionals. It moves the UK a step further towards being debtor as well as creditor friendly and it will hopefully provide an environment in which companies are not afraid to come forward, identify their problems and seek possible ways of solving them – sometimes no doubt with the help of turnaround professionals. The proof of course will come once we begin to see how companies, banks and turnaround professionals work together under the new regime.

Keith Bordell
is a partner in the
Corporate Recovery
Group at Travers
Smith Braithwaite.

