Company Voluntary Arrangements: What are they and why do they happen?

The term Company Voluntary Arrangement ("CVA") entered the legal dictionary in 1986. Since then the world has changed dramatically but the idea which underpinned the introduction of CVA's remains, namely to maintain value in Companies which suffer short term financial difficulties.

So what are CVA's and why are they becoming more prevalent now? Hopefully this short article will provide the answers.

What is a Company Voluntary Arrangement ("CVA")?

I see so many definitions of what the procedure is and most are framed very narrowly within a given set of circumstances that individual authors are trying to get across. The beauty of the procedure is however that the basics are very simple and wide ranging.

Put simply, a CVA is an agreement between the Company and its creditors to amend the repayment terms of the Company. It requires all creditors to be treated equally and crucially, provided 75% by value of creditors agree to it the terms, the remaining 25% are similarly bound by them. The basis of the agreement is a proposal and creditors meet to agree the terms.

The terms can involve a write off of debt, but although most include an element of debt forgiveness this is not necessarily always the case. The final terms are always likely to involve a negotiation between major creditors and the Company.

So that's it! But as with many things, the devil is in the detail.

Why does it happen?

The sheer flexibility of the CVA process can also be its Achilles heel. On a historical note you can view the development of the detail of the procedure as being a battle between Creditors and Debtor Businesses, as each tries to maximise their outcomes from the procedure to the detriment of the other. The legislation assumes a good faith negotiation, hence the only real safe guard it provides to halt the unscrupulous, is a requirement that a simple majority of non-associated creditors can veto a CVA.

Just how achievable the goals of Creditors and Debtors are would be a matter for a Doctorate and is way beyond the scope of this article, but it is important to recognise the impact of the human element to the decision making here.

I have seen Directors considering between Liquidation, Administration and Voluntary Arrangement based on the accounting information to hand. That information can be merely historical or in some cases, hysterical as many SMEs fail to see the importance of good record keeping (not least the fact it's a requirement of any company in the eyes of the Law). In the end their decision to consider a Voluntary Arrangement was as much to do with their personal goals and expectations as any other factor!

As the Insolvency Practitioner in the middle it can all get a bit fraught particularly when you see a good achievable deal being given up in favour of one which has almost no chance of success. This is even more the case when you later discover that the agreed CVA was merely the centre piece of a much wider net of side deals and promises.

But there are a number of factors which will be common to the procedure:

1 Where is the Money?

Running a Small Businesses is usually a matter of Directors managing scarce resources and ensuring that those resources which are deployed are done so profitably. Everyone makes mistakes and suffers misfortunes and there will always be times when individual small businesses are not adapting quickly enough or no longer have the financial resources sufficient to manage a change from loss to profit.

The reaction to this will see Directors begin hunting around for money. Sources of funds will almost always be bank lending in some form as this still maximises the Directors view of the control they will maintain over the business.

The loans may be either personally or corporately based and, when new funding is either to expensive, or difficult to achieve the Directors will have to consider what other options are available. This tends to be when we get the call.

2 Acceptance of Management at an Early Stage

The facts as I describe them above, paint a picture of careful planning, preparation and understanding of business by owner managers which is generous. Few business owners plan much beyond the end of the month, let alone the multi-year business plans so loved by the literature on the subject.

A phone call from a Director which confirms that in three months they will run out of money is a rarity. Even in large Companies it will be difficult for the Board to accept, even when they can see the car crash coming, that they have lost the time and resources to influence the outcome.

So more often the phone call comes after something external has happened, whether it be a major customer going into insolvency, or the wage payment date has come and gone with insufficient funds in the bank account to pay them.

It is not to say, in those circumstances that a CVA is not possible, but as will be explained later, significant damage will already have been done to the relationships between the Company and its creditors to allow for a purely commercial non emotional discussion to occur.

3 A viable business remains

Most business owners view the insolvency industry as the angel of death swooping down to damage the livelihoods of hard working business owners. I am clearly not going to agree with this analysis, but it is important that we realise that businesses and how to make money out of them is continually evolving. Despite the potential for harm to a few, it is the majority of us that initiate the changes which causes the damage.

No one would I think suggest that sending small boys up chimneys to clean them represents a good business model. But when that change happened, some individuals will have suffered.

In more recent times I can recall the birth and death of the rental video library. I don't think anyone would suggest that DVD's or the internet should have been held back, but as sure as night follows day progress causes damage to some.

So, the first question we ask Directors considering a Voluntary Arrangement is "Do you have a viable business?" The second is to ask them to commit that viable business to an outline business plan so that we can critique what they are proposing.

This type of planning is new to many business owners and, for some, probably for the first time, they get the opportunity to take a focused look at their business.

4 Goodwill of the Customer Base and file at HMRC which is not too large

This is a double point; so first HMRC.

HMRC are the biggest influencer on Voluntary Arrangements. They have so much information on the business gathered over months and years that, if it were shared would add dramatically to the process. They don't provide any information and instead seek to impose their precise requirements and methods of operating onto the Arrangement for their sole benefit.

The result can be a Voluntary Arrangement being changed from something that had a good chance of succeeding to one which has very little chance. But, by this stage the Directors are so desperate for the process to be given a chance that they agree to the changes, rather than admit at that time that the Company's business is over.

I do not mean for this section to be a diatribe aimed at HMRC, but I have many examples in my practice, of information coming to my attention which explains HMRC's attitude to the Proposal sometime later when the die was cast and I have little ability to change anything. In most of these cases the CVA enters the list of failed procedures and we all move on. Very few seek to learn from the experience.

But it is important to understand HMRC's view of insolvency procedures in general. They perceive everything in terms of debt collection and, where they allow someone to avoid a more formal insolvency, they want to ensure that they do better than they would if they don't. So the long term survival of the business is not part of their decision making process.

As a balance here we must mention the recent case of Rangers Football Club where, on the strength of HMRC's claim the CVA was not agreed. From the perspective of supporters of Rangers I can wholly understand how devastating a decision would have been for them. But from HMRC's perspective they have been vindicated. Receipts into the subsequent Liquidation have been significantly more than would ever have been achieved into the CVA due to a number of Liquidation specific areas of recovery.

So another early question to Directors is how much does the Company owe HMRC and are they likely to cooperate. I.e. have you filed everything you need to file, are you on a payment plan etc. Generally, the more non standard interaction a Company has had with HMRC, the less likely they are to agree to a CVA.

On a wider note as with any agreement you need both sides to feel that they are getting something out of it. A viable CVA will put pressure on both the Company and its suppliers. If the business owner has not treated his suppliers in what they perceive to be a reasonable manner it is likely that they will not give them the benefit of the doubt that the CVA will work. For most businesses, without the suppliers you don't have a business.

5 Management identify fundamental changes to running the business.

It is very rare that the only underlying problems associated with Company's financial problems are external in nature, although it is less rare that Directors look purely to these external factors to explain their predicament.

So, irrespective of what I am told the underlying problems are, I always ask Directors what they are going to do differently this time? We usually frame this in terms of, how do we avoid this in the future? Even if the answer is merely to avoid doing large amounts of business with customers who go bust allows us to coach such things as credit checking and constant debt collection etc.

6 No Access to funds to Business Owners / Managers to allow buyout of assets

The above all tend to be positive attributes associated with the CVA process. These is however one negative area that we need to look at. In most cases a CVA will add pressure to the business. There can be benefits, at least initially with cash flow and Management time but generally the involvement of an Insolvency Practitioner in a business will, over time, detract management from more positive areas of their business' development.

Further, business owners will know where the bodies are buried in their existing business and so will value the business higher than third parties. If they can find sufficient outside funds therefore we always advise them that they are the natural purchaser of their own struggling business. Our advice is clear on this point. If you can find sufficient funds to pay materially more than third parties and you wish to maintain the business you should look to appoint an Administrator.

And before I get a load of complaints that I am an advocate of Phoenixing and defrauding creditors, I am not advocating a management of the process to benefit the existing management and to the detriment of creditors. But, I deal with reality, rather than what we would like the world to be. If I am being employed to maximise the value of a business then that is what I will do. I don't think personal political agendas add anything of value to the process.

So that's it! CVA's in six easy steps. If only it were that simple.

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