Zombie Companies

What is a Zombie Company?

The term Zombie Company has grown up in the media and with economic observers to describe companies that are living 'a hand to mouth existence', only generating sufficient cash to meet the interest on their debts but insufficient to reinvest and grow their business.

Often these businesses survive due to the support from lenders, trade and crown creditors. This support is, however, limited to secured creditors not enforcing their security, and trade creditors and HMRC not taking recovery action against past debts. Research undertaken by R3, the trade association of licensed insolvency practitioners, has estimated that there are some 146,000 companies that can be described as Zombies operating in the UK economy.

A number of economic observers have commented that these Zombie companies are holding back the prospects of growth and investment in the face of the prolonged economic downturn. They are utilising both labour and capital and taking demand for products, all of which would be better utilised by companies which have better prospects of growth and forward investment.

The view is growing that these companies need to be brought to an end in order to free up the resources that they are utilising. However, unlike past recessions, insolvency practitioners have not experienced a growth in formal insolvencies. Recent figures released by the Insolvency Service, apart from the growth in the administrations of companies employing 500 plus employees, indicate that insolvency numbers have been steadily declining.

Why is it that in this recession, Zombie companies have been able to survive, whereas in previous downturns they

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would have gone to the wall. The explanation can be found in the change of attitude amongst creditors and the benign economic conditions that exist.

Changes in Attitude

Firstly as regards the change of attitude, we can look at the Banks who supply overdraft facilities to these Zombie companies. Whereas in previous recessions the Banks would have enforced their security over the company's assets to recover its debts, currently, with both political pressure on Banks to be seen supporting of companies and the financial pressure to repair Banks balance sheets there is not the will to enforce security over assets. Indeed, the Banks are continuing to support but reducing over time overdraft limits and thereby giving the Zombie company a slow death, without having to make a provision on the Banks balance sheet. They do not wish to be seen as the cause of Insolvency.

In addition, trade suppliers, with the difficult conditions that exist, are reluctant to take enforcement action against past debts and will often continue to supply, even if on cash on demand terms looking to recover some profit against the debt that has already been incurred.

The position of HMRC has become confused. Under the past government at the commencement of the downturn in 2007, HMRC were willing to enter into formal 'time to pay arrangements' with companies, often following one telephone call from the management. These positions are being unwound but insolvency practitioners operating in the SME market, are finding that HMRC remain willing to agree to informal arrangements to repay past arrears of debt and will only seek formal recovery action where these have failed or the Zombie company is not talking to HMRC. This continued support both by lenders and creditors of Zombie companies has been termed "extend and pretend".

Insolvency for Growth

In any market based economy, insolvency is a fact of life. The market economy needs the removal of insolvent, dead or Zombie companies in order to free up the facilities, capital and labour being utilised to be re-distributed to companies with prospects of growth and investment.

Insolvency Practitioners can assist in this process by the use of restructuring procedures such as administrations (sometimes involving a pre-pack sale) and CVA's to preserve value, secure ongoing employment and possibly more importantly, free up the Zombie business cycle of servicing debt in order that underlying sound businesses can grow.

This enables the restructuring of viable but underperforming businesses for the benefit of the economy. Where the business is no longer viable, resources utilised are freed up for the benefit of the economy and the demand is switched to those companies with prospects of growth. Insolvency practitioners have an important part to play in the future growth prospects of the economy but they cannot do this without a change in attitudes from lenders and creditors towards the Zombie companies they are supporting.

However, with the economy starting to show signs of a recovery, the crunch time for Zombies could be getting closer. With sustained moderate growth in the economy, creditor attitudes may well change as the Zombies become more obvious to creditors, as they are unable to take advantage of the improved conditions. This together with a more pro-active H. M. Customs and Revenue pursuing outstanding taxes, and regulatory pressure on the Banks to recognise and provide for bad debts could result in the days of the Zombie companies being numbered. If so, it will be the task of Insolvency Practitioners to rescue and restructure those businesses with an underlying viable model.

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