Voluntary Administration: Myth versus Reality

5 myths dispelled

Many businesses have been financially challenged by the recent tough economic environment, to the extent they're so burdened by legacy debt they are unsure if they can continue operating. But rather than wait until it's too late to do anything about it, it makes more sense – particularly financial sense – to consider options, such as voluntary administration.

Voluntary administration (VA) involves appointing a voluntary administrator who investigates the business's finances and provides a recommendation to creditors as to whether the business can be saved or if it should go into liquidation. During the VA period, a moratorium is created on creditors' enforcement rights, providing much needed breathing space for directors and management to work with the administrator to find the right solution for the specific circumstances. The issue we find when talking to clients, is the number of misconceptions or "myths" associated with VA.

Here, I've dispelled five of the main ones.

1. Voluntary administration will be the death knell for my business

Rather than losing your business, a VA is used to determine if your business is able to carry on. Perhaps you had a one-off financial shock, such as a major debtor not paying an invoice, or suffered under the trading restrictions of the pandemic. If your business is a good one with a profitable product, then a VA is a way to get it back on its feet. The VA provides a mechanism to approach your creditor group, explain the circumstances, and seek their support by way of compromise or forbearance to allow the business to "trade-out" of the situation. The voluntary administrator, an independent third party, investigates the circumstances leading to the financial distress and provides a recommendation to creditors on the business rescue proposal.

2. I'll lose control of the business if I hand it over to an administrator

In fact, administrators work very closely with you and the management team of your business – after all, you know your business better than anyone. Generally, the administration period runs for about six weeks, after which control of the business is returned to the directors if creditors vote to accept the rescue plan. During the administration period, the voluntary administrator will usually work with the directors to form a proposal that deals with how the company will operate in the future, what assets may need to be sold or retained, and how creditors will be paid.

This proposal is then put to creditors at a meeting in the form of a Deed of Company Arrangement (DOCA) and voted on. A DOCA aims to produce a better outcome for all parties, rather than choosing to enter into liquidation.

3. I'll no longer be able to trade

A VA is all about giving businesses a second chance. Rather than stopping you from trading, it protects you from *insolvent* trading. When you enter into a VA, there is a moratorium on claims on company debts from your creditors and this gives you much-needed breathing space to get back on track without the pressure of creditor demands. This can include continuing to be able to trade.

During the VA period, the administrators are personally liable, under statute, for the debts that the business incurs. This is deliberate and designed to create confidence among creditors, so they maintain supply through the process. Even when trade accounts have otherwise been put on “stop credit”, suppliers are likely to continue to supply the business in administration as they are confident that they will be paid.

4. I’ll be liable for any personal guarantees

The time to consider personal guarantee (PG) exposure is before you sign them – they should not be provided lightly. But if you are unable to avoid a PG and your business becomes distressed, the risk of the business debt becoming your personal debt is very real. While a VA cannot cure a personal liability created by a PG, it can delay the enforcement and often protects your revenue stream, such as salary or dividends, to assist with discharging the debt in due course.

While a VA is in effect, PGs over directors can’t be enforced. Although bear in mind, if your company goes into liquidation, they can be exercised.

5. I can say goodbye to the good business reputation I’ve built up

It’s easy to think that because your business is struggling then you’ve failed. This is one of the most common things we hear. But the reality is, many issues that businesses face come about from events outside your control. A VA aims to save companies, giving them a chance to reset and hopefully emerge stronger than before. If action is taken early, any damage done to your business can be reduced.

As an example, think of your car insurance. While we all want to protect our no-claim bonus, if you have a car accident, your primary concern will be getting the vehicle back on the road. Once repaired, you can begin rebuilding your no-claim bonus – it’s not gone forever – and if the accident was not your fault, it’s often not lost at all. Business distress is similar to a car accident: the financial distress must first be repaired and then the business can rebuild its reputation. But if the distress came about due to extraordinary events outside of the business’s control, the transparency of a process Ike a VA will protect the reputation of the business and its owners.

A successful VA is built on acknowledging that there has been a problem, but working towards a solution that improves the position for creditors and other stakeholders. The proactive nature of the process involves delivering a solution, not lamenting a problem.

Act early

Rather than dreading a VA, it’s best to view it as a support mechanism that can help you get back on your feet. If your business is struggling, the earlier you seek professional help, the more options will be available to you.

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