BREAKFAST BRIEFING

'Are Company Voluntary Agreements (CVAs) Fit For Purpose?'

Guest list:

Steve Barber – Non-executive Director and Chair, Audit Committee AA plc formerly Next plc

Rt. Hon David Davis MP – MP for Haltemprice and Howden, Former Brexit Secretary

John Kay – Economist

Howard Kerr – Chief Executive**,** BSI Group

Justin King CBE – Vice Chairman, Terra Firma**,** Chairman Wyevale Garden Centers and former CEO, J Sainsbury's

Bob Ivell – Chairman, Mitchells & Butler plc and Carpetright plc

Mike Rees – Founder Strategic Vitality, Former Deputy Group CEO, Standard Chartered

Steve Richards – Group Chief Executive, The Casual Dinning Group

Brigid Simmonds OBE – Chief Executive, The British Beer & Pub Association

David Wormsley – Chairman, UK Banking, Citi Group, Governor Museum of London

P.T.O
For Briefing Note.

Briefing Note – written under the “Chatham House Rule”:

Introduction

The strategy breakfast idea came about after speaking with a number of our clients and contacts and hearing that many felt that in the current market the law around insolvency and in particular, the abuse of the Company Voluntary Agreements (CVA).

Abuse of the CVA

The discussion started with a view that there were many high-profile abuses of the CVA. A guest, with a wry smile, declared that in danger of being hypocritical they had used a CVA where they were able to save 150 out of 220 jobs giving it a chance to succeed. While it did not ultimately succeed, they were able to return a small amount of money to shareholders and ultimately wind the company up in an orderly fashion.

However, CVAs are being used wrongly – retailers, in particular, now feel that it is the only leverage they have with landlords. CVAs have ultimately become part of the problem, not the solution. Their misuse has led to a collective enfeeblement of businesses. By using them, businesses are allowed to go through various renaissances and still ultimately not survive.
It was commented; that this causes knock-on effects including on productivity – businesses which shouldn’t survive do. The enfeeblement also impacts successful businesses in the market. The same management teams often recycle with the same flawed business plan and poor products.

Leases are on average six years long and getting shorter so this will help address the problem.

Shopping Malls

The conversation moved onto shopping malls – they are a different story commented a guest. Landlord’s cant provide a discount to one unit of twenty, or they get serious push back from the other nineteen.

Overcapacity

One problem we have is over capacity – a stagnation of the economy and growth of the internet as a means of shopping contributes to this. Capacity needs to be eliminated. CVAs do not help with this – they help the weaker players to survive.
The zombification of businesses (both successful and failing) as a result. Commented another.

The rise of the Hybrid Business

I am intrigued by the problem of what type of insolvency plan we should have. The proliferation of what I refer to as ‘hybrids’ – businesses largely providing public services, such as hospitals, utilities, care homes and schools – they all have systems in place to save them.
The overriding priority if a water company fails is to keep the taps running, so that the ‘innocent bystander’ – the customer, the patient or the pupil – is not affected. This was also true of Carillion. This model is very different to the competitive retail sector. This is a wide-ranging problem that demands rethinking insolvency legislation. These businesses are usually operating in the public-private space and debt is quasi-equity. The number of these businesses is huge because there are so many NHS trusts and academies; the share of GDP for ‘hybrids’ is probably around 25%.

Another guest disagreed saying: There was no real ‘risk transfer’ for these companies when they were privatised. What we need is to facilitate the clean demise of dying companies without zombifying them and allowing them to take down other parts of the economy with them. It is better for them to have a sudden death. What is a good insolvency mechanism?

CVAs operate on the thesis that there is a vibrant business within a company to save. About 15-20% of businesses survive after a CVA.

What needs to happen is we must think about planning reform in order to allow retail/business units to be used again for other purposes. Charities are examples of 'businesses' which do quite well in terms of rent and avoiding the minimum wage with volunteers. You don't want to be competing against Oxfam.

Overcapacity?

Landlords have continued to expand retail parks and encouraged casual dining and food to enter their parks. Landlords have got away with upping rents and expansion without many checks. In some towns, there are what I call 'secondary retail parks' and they will go bust. Some businesses have/are renting large spaces in retail parks which are in close proximity to one another, with high rents. Some businesses will continue to open more and more stores without questioning: what is the maximum number for our chain?
Has this changed asked another? I know several developers and they have noticed a decline from several years ago.
Casual dining is expanding in these parks, driven by private equity. They adopt the strategy of opening as many shops as possible and then selling-out. Landlords love bringing in dining as well.

The original notion of the CVA

We should not protect businesses from their follies when they do things like this. The original notion of CVAs was to copy [the USA's] Chapter 11. In the USA, there was a serial-entrepreneur spirit. Now CVAs are a feather pillow for death.
A fellow guest quipped: If you have ten businesses, five are losing money and five are making a profit, albeit a small profit, are the latter five worth saving with the remaining money you have? Should we allow competitors to pick over the remains? Surely it is better to save those five.
We need to reduce retail capacity while rewarding better retailers. We are not doing the latter. Most CVAs we have been discussing relate to businesses which do not have a viable business core to save.

The Capitalist Society

We live in a capitalist society, where the weak should fail. New Look etc. have bad debt/management – who is answerable for these failings?
We need to make a distinction between debt and equity – it doesn't mean what it did fifty years ago.
It is not always obvious what order are liabilities stacked in? Pensions etc.
Woolworths real estate went to businesses like pound stores, Boots, New Look etc., so Woolworths' failure was good in the mid-term for these businesses which picked up their real estate. There are around 200 units from Woolworths' property portfolio which are unviable and remain empty.

Legislation

Another chipped in: What worries me is legislation, which can be like using a sledge hammer to crack a nut. It's inflexible. For instance, there are 48,000 pubs in the UK – we can't keep all of them open. I am frightened by councils controlling business rates. Local Authorities need to move faster on planning issues – they don’t understand.

Innovation

Boxpark in Shoreditch started out as containers on land owned by Network Rail. It brings together common businesses (retail, food etc.).
It’s an example of how the market is adjusting. It also highlights how people are looking for an experience [while out].
If you had the ‘dead space’ of shops going bust, the market would respond and the space would be recycled.

Conclusions

There appears to be a need to look at tweaking the law and promoting best practice. The view was that the market abuses of CVAs is bad for business. It penalises well run businesses when poor management teams, with weak business plans are allowed to recycle with no penalties leaving investors and landlords nursing heavy losses.
When it comes to Hybrid companies there needs to be more attention paid to “living wills” to prevent disorderly collapse requiring the state to step.

There was little appetite for a new government body to regulate this. However, some finessing of existing law and better stewardship by shareholders, pension trustees and other key stakeholders is required.