

DIRECTORS GUIDE

THE ADVANTAGES AND DISADVANTAGES OF A CVA

A **Company Voluntary Arrangement (CVA)** is a formal insolvency procedure that allows a company to continue trading while repaying a portion of its debts over an extended period. While it can be an excellent tool for rescuing a company in financial distress, it comes with both advantages and disadvantages that directors need to understand before deciding whether it's the right route.

This guide will help directors evaluate the pros and cons of entering a CVA, providing them with the insights needed to make an informed decision.

 01702 344558

 enquiries@dcabr.co.uk

 www.dcabr.co.uk

 18 Clarence Road,
Southend on Sea, SS1 1AN

Advantages of a CVA

1. Continued Business Operations

- **What it means:** A CVA allows the company to remain in operation, meaning the business can continue trading and generating income.
- **Why it matters:** The company does not need to cease trading like in a liquidation, giving it the chance to recover, regain profitability, and rebuild its market position. This is especially valuable if the business is viable but struggling with cash flow issues.

2. Protection from Creditors

- **What it means:** Once the CVA proposal is approved, the company is protected from creditors taking further legal action to recover debts covered by the arrangement.
- **Why it matters:** This breathing space allows the company to focus on rebuilding its operations without the immediate threat of creditor action, including legal proceedings, bailiffs, or winding-up petitions.

3. Reduced Debt and Restructured Payments

- **What it means:** A CVA allows the company to negotiate reduced payments to creditors over a period (usually 3-5 years).
- **Why it matters:** This can provide much-needed relief, as the company can repay only a portion of its debts, potentially reducing the overall debt burden. The company can often agree to more manageable monthly repayments, enabling better cash flow management.

4. Retention of Control by Directors

- **What it means:** Unlike liquidation, where control is handed over to the liquidator, in a CVA, the directors usually retain control of the business, as long as the terms of the CVA are adhered to.
- **Why it matters:** Directors can continue managing the company, make operational decisions, and guide the business through the recovery process, maintaining their leadership role.

5. Avoidance of Insolvency Stigma (in some cases)

- **What it means:** A CVA can be seen as a less drastic solution compared to liquidation or administration, as the company remains in business.
- **Why it matters:** This can help preserve the company's reputation, protect its brand, and maintain supplier and customer confidence. It allows the company to position itself as restructuring rather than failing.

6. Employee Retention

- **What it means:** The company can continue to employ staff, avoiding mass layoffs or redundancies that typically occur in liquidation.
- **Why it matters:** Employees retain their jobs, which can help maintain workforce morale and loyalty during the challenging recovery period. This also helps prevent skill gaps that may arise in the event of redundancies.

7. Flexibility in Negotiations

- **What it means:** The CVA process involves negotiations with creditors, giving the company some flexibility in terms of payment schedules, amounts, and terms.
- **Why it matters:** This provides the company with the opportunity to address the needs of the business while providing creditors with something rather than nothing, leading to a potentially win-win situation.

Disadvantages of a CVA

1. Strict Conditions and Oversight

- **What it means:** Once a CVA is approved, the company must comply with the terms set out in the proposal. The arrangement is supervised by an Insolvency Practitioner (IP), who ensures the company follows the agreed payment schedule and operational constraints.
- **Why it matters:** This level of oversight can limit the flexibility of the company's operations. The directors must strictly follow the CVA terms, or the agreement could fail, leading to the company being forced into liquidation.

2. Potential Impact on Creditworthiness

- **What it means:** While the company can continue trading, it may still be perceived as a financial risk by lenders, suppliers, and investors.
- **Why it matters:** The company's ability to access credit could be severely restricted during and after the CVA period. Financial institutions may be unwilling to offer additional financing, and suppliers may demand stricter payment terms or even refuse to trade on credit.

3. Risk of CVA Failure

- **What it means:** A CVA is not a guaranteed solution, and if the company fails to meet the agreed payments or other terms, the CVA can be terminated.
- **Why it matters:** If the CVA fails, the company may be forced into liquidation, and creditors could potentially receive even less than under the CVA. The business would lose the opportunity to recover, and the directors could face personal liability if they're found to be in breach of their duties.

4. Reputation Risk

- **What it means:** Although a CVA may be seen as a less drastic option than liquidation, it is still a formal insolvency process, and stakeholders (including customers, employees, and suppliers) may see it as a sign of financial weakness.
- **Why it matters:** The company's reputation could suffer, and it may struggle to rebuild trust with customers, suppliers, and employees. Employees may worry about job security, and customers may hesitate to do business with a company in financial difficulty.

5. Limited Scope for Creditors to Recover Full Debts

- **What it means:** A CVA involves creditors accepting a reduced repayment, meaning that they may not recover the full amount owed.
- **Why it matters:** While this may be beneficial for the company in terms of financial relief, creditors may be dissatisfied with the arrangement. This dissatisfaction could affect ongoing business relationships or make it harder to secure future credit or support.

6. Potential Reductions in Employee Benefits

- **What it means:** As part of the CVA process, the company may need to restructure its operations, which could include changes to employee benefits such as bonuses, pensions, or other perks.
- **Why it matters:** These changes may affect employee morale and lead to resentment or disengagement. Employees may also fear further cuts or redundancies during the CVA period.

7. Personal Guarantees May Still Be Enforced

- **What it means:** In a CVA, the business is still responsible for certain financial obligations, and personal guarantees given by directors may remain enforceable if creditors are not fully repaid.
- **Why it matters:** Directors who have provided personal guarantees could still be personally liable for unpaid debts, which could lead to financial hardship for them. Directors should carefully consider the impact of this before agreeing to a CVA.

Summary: Weighing the Advantages and Disadvantages

The decision to enter a CVA should not be taken lightly, as it has significant implications for both the company's operations and the directors' responsibilities. Here is a summary of the key advantages and disadvantages to consider:

Advantages

- Opportunity for the company to continue trading and recover.
- Protection from creditor action and legal proceedings.
- Reduced debt and manageable repayment terms.
- Retention of control by directors.
- Employee job security and retention of key talent.
- Flexibility in negotiating with creditors.

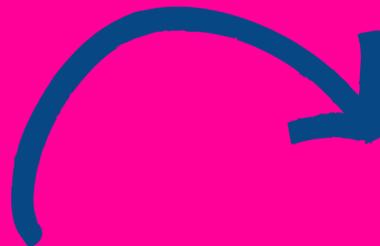
Disadvantages

- Strict conditions and oversight from the Insolvency Practitioner.
- Potential negative impact on creditworthiness and business relationships.
- Risk of failure and the possibility of liquidation.
- Reputation risks and potential harm to stakeholder confidence.
- Possible reductions in employee benefits and morale.
- Personal guarantees may still be enforced, leading to personal liability.

Conclusion: Is a CVA Right for Your Company?

A CVA can be an effective way for a struggling company to survive and recover, allowing it to pay a portion of its debts while continuing to operate. However, it requires a careful assessment of the company's financial health, future prospects, and the willingness of creditors to support the arrangement.

Directors should weigh the advantages and disadvantages, considering not only the impact on the company but also the implications for employees, creditors, and their own personal liabilities. Seeking professional advice from an insolvency practitioner is essential to understand the best course of action for your company.



**Arrange a free
initial advice
meeting with
us today**