

## COCOONING A BUSINESS

Written 24<sup>th</sup> April 2020

The purpose of this guidance is to give an overview of what, why and how a business might be cocooned (or mothballed) in response to the change in trading environment arising from Covid-19.

### What is Cocooning?

- Cocooning, or mothballing, is a temporary suspension of a business and can be the result of sales reducing to zero (or nearly zero)
- All cash outflows where possible are stopped or reduced and the business is left in a state which it can emerge from once the prevailing business conditions improve

### Why would you do it?

If there is a temporary change in business environment like we are seeing from Covid-19 then business owners have the following decision:

- Continue trading (and possibly benefitting) (e.g. delivery companies)
- Move trading online (e.g. universities, schools)
- Pivot the business (e.g. restaurants doing take away)
- Repurpose to produce in-demand goods (e.g. BrewDog hand sanitiser)
- Cocoon the business temporarily
- Solvent/Insolvent liquidation

As Covid-19 has reduced revenue for many businesses to zero (or close to zero) it may be pragmatic to cocoon the business until conditions improve.

The decision to cocoon is likely to be difficult and the following are some thoughts to help business owners make the decision.

- **Customers and suppliers** - if the business is a vital link in a supply chain then there may be an opportunity to agree with customers / suppliers for relaxed terms to continue trading.
- **Expected revenues** – If the expected revenues for the business in the next 3 or 6 months are zero or close to zero it might make sense to cocoon the business. However, if there are some revenues still being generated but these are below normal levels then it may be useful to put some forecasts together (see next point).
- **Short Term Financial forecasts** – Preparing two cashflow forecasts will help set out the numbers (we can help with this). If this is the first time the business has prepared a cash forecast a good place to start would be the business bank statements to find the payments that the business typically makes. The first forecast is assuming

the business stays open, revenue is lower than normal (because of Covid-19) and some costs are reduced whilst trade continues. The second forecast should show the cash impact of cocooning the business with no trading and as many costs reduced as possible (more detail on this below). Comparing these two forecasts will show whether it is more costly to keep the business open on lower revenues or to cocoon the business.

- **Longer Term Financial Forecasts** – Despite the uncertainty it is helpful to have a business plan which shows the best estimate of how the business will recover. If the businesses cocoons itself then having a plan about what happens when the business restarts, how long it takes to generate cash again and how it can pay back its creditors will help when speaking with creditors, banks, HMRC etc.
- **Other considerations** should also be taken into account such as what impact this may have on your customers & suppliers in the long term, how quickly the business can return to operation after cocooning and how long this interruption is likely to go on for.

It is recommended that business owners take advice when considering their options and we are well placed to help.

### Principles to follow when Cocooning

**Prioritise** - Focus attention on the biggest cost items and those critical to the future of the business. These are the ones which need attention first and will have the biggest impact (e.g. payroll, rent). Once these are managed attention can be turned to the smaller / less critical costs.

**Communicate** – Ensure that relevant stakeholders are being informed of what is going on. Remember to be honest and upfront (even if delivering bad news) as this will help maintain relations with stakeholders.

**Negotiate** - These are unprecedented times and every business and person will have been impacted by Covid-19 in some way. This means there are no agreed solutions and the opportunity to negotiate and find novel ways of dealing with problems is likely.

**Think long term** - Just as important as how you cocoon the business in the first place is thinking about how you unwind what you do in the future. Simply stopping paying creditors is likely to mean there will be a stack of overdue demands when returning the business to operation in the future. The solution is communicating and trying to find solutions that work for both parties such as incentives, payment in kind etc.

## How do you do it – maximizing cash inflows?

When cocooning a business, all potential sources of cash should be pursued. This includes:

- Collecting any outstanding **trade debtors**.
- Considering whether **liquidating stock** is appropriate. Having the cash now may be a benefit but could impact the speed and cost of re-starting the business in the future.
- Apply for a refund of any **Statutory Sick Pay** which may be due as a result of the government changing the criteria. Not available yet but more details can be found here: <https://www.gov.uk/guidance/claim-back-statutory-sick-pay-paid-to-employees-due-to-coronavirus-covid-19>
- Applying for **available grants**:
  - Small business grant funding of £10k for all business in receipt of small business rate relief or rural rate relief
  - Grant funding of £25,000 for retail, hospitality and leisure businesses with property with a rateable value between £15,000 and £51,000
  - See 'Business Rates' document in resource center
- Review **insurance policies** to see if there is a claim that can be made against pandemics, government ordered closures. Policies differ significantly between insurers for what they cover so it is recommended to check.
- It is possible the business has material **customer contracts** in place which may not be fulfilled as a result of Covid-19. In this instance, the customers should be contacted to explain the situation re Covid-19 / cocooning. Some contracts may be covered by a Force Majeure clause which gives relief from fulfilling contractual obligations.

## How do you do it – minimising cash outflows?

Prepare a breakdown of the costs in the business so all expense lines can be seen. Bank statements are a good place to start. Some of these are likely to be variable costs which have already stopped, whereas some are fixed (e.g. rent). All of these costs need to be considered when cocooning as the target is to minimize or stop all costs.

The process should start with the largest and most business critical expenses such as payroll and rent and then work down to the less essential and smaller items.

If expenses are non-essential and the supplier is unlikely to take enforcement action then the simplest approach would be to stop making payments and explain your position with them.

It is worth considering directors duties when making this decision and, if the business is near insolvency, then Director's duties towards the creditors take priority. More details below on this.

## Payroll

- When cocooning the business it is likely that all staff will be furloughed through the Coronavirus Job Retention Scheme (CJRS). The conditions of the CJRS means the employees cannot do any work for the business. Details of the CJRS have been analysed separately and are available on our website.
- Key facts of the CJRS are:
  - Minimum period of 3 weeks
  - Covers 80% of salary (plus NI + minimum pension)
  - 3 months from 1 March 2020 (currently)
  - First payment in April so potential cash requirement of business to cover salaries until refund received
  - Cash squeeze may be covered through commercial banks offering overdrafts and agreement to defer salaries with staff
- The directors of a cocooned business can also be furloughed. The Government have said that directors may fulfil statutory obligations but should not generate commercial revenue or provide services. More detail can be found here: <https://www.gov.uk/guidance/check-if-you-could-be-covered-by-the-coronavirus-job-retention-scheme>
- Whilst using the CJRS seems the most appropriate for cocooning the business it may also be worth considering other options including:
  - If some staff need to be kept on could their salary be reduced or deferred in return for more holidays, a bonus once operating starts again etc.
  - Redundancy – however this is likely to be expensive when staff can be put on CJRS. Also need to consider recruitment (time and costs) when business starts running again.

## Rent

- **Key steps**
  - *Stop rent payments being made*
  - *Communicate with your landlord*
  - *Take advantage of the Government creditor moratorium (see below)*
- Take advantage of the Government scheme
  - The Government introduced a creditor moratorium in relation to commercial tenants on 23<sup>rd</sup> March 2020 and runs through to 30 June 2020.
  - This means that a business is protected from action brought by its landlord including eviction if it fails to make payments as a result of Covid-19. More details are here: <https://www.gov.uk/government/news/extra-protection->

### [for-businesses-with-ban-on-evictions-for-commercial-tenants-who-miss-rent-payments](#)

- The advice is to speak to your landlord early and explain the situation. If the business was a good tenant before the crisis and as a result of Covid-19 has decided to cocoon then the landlord should be willing to reach a solution which works for both parties.
- The business doesn't want to come back to rent demands once it restarts trading so agreeing a reduction / payment over time once trading restarts might work best.
- There have been a number of examples where landlords have agreed rent holidays or deferrals and there are many other options to discuss including rent reductions, changing in terms, part occupancy and turnover based rents.
- The Government imposed moratorium covers rent payments but not service charge or other agreed leasehold costs which remain payable. Again, speak to the relevant parties and come to an agreement.
- Lots of examples of business not paying rents
  - <https://www.telegraph.co.uk/business/2020/03/31/jd-sports-stops-paying-rent-landlords-amid-governments-high/>
  - <https://www.telegraph.co.uk/business/2020/03/25/thousands-shops-will-never-reopen-outbreak-ends/>
  - <https://www.ft.com/content/b83230e2-c2ee-4d39-b3ef-996cedec1585>

### **Rates**

- **Key Steps**
  - *Stop payments being made*
  - *Take advantage of the Government scheme if possible*
  - *Speak to council to inform them of your situation and agree a payment deferral*
- Take advantage of the Government scheme
  - 12 month business rates holiday for all retail, hospitality, leisure and nursery businesses (in England)
  - See: <https://www.gov.uk/apply-for-business-rate-relief>
  - Chances are that many businesses which choose to cocoon will be in this category
- Some local councils are bringing in Covid-19 support measures to delay or change the payment terms. Here is an example: [https://www.cheshireeast.gov.uk/business/business\\_rates/business-rates-relief/coronavirus-covid-19-help-for-business-rates-customers.aspx](https://www.cheshireeast.gov.uk/business/business_rates/business-rates-relief/coronavirus-covid-19-help-for-business-rates-customers.aspx)

- Like Time to Pay with HMRC, Councils have in the past agreed to paying rates bills in installments to spread the costs.
- The advice is to speak to the council early, inform them of your intention and come to an agreement which works for both parties.

## Tax / HMRC

- VAT
  - **Key Points**
    - *Cancel direct debit and don't pay VAT for this quarter*
  - Take advantage of the VAT payment deferral for the next quarter
  - The government has allowed businesses to defer VAT payments between 20 March and 30 June 2020 meaning any quarterly VAT payments which are due to be made in that period (or all of the monthly VAT payments if the business pays on monthly) can be deferred
  - To receive this the VAT return a business needs to:
    - Submit the VAT return in time
    - Cancel the direct debit to HMRC
    - But – the business does **not** need to inform HMRC that they are deferring payment
  - However, if the business receives a VAT refund these are still being paid so VAT returns should be submitted as soon as possible.
- Time To Pay (for all tax due)
  - **Key Points**
    - *Speak to HMRC on 0800 024 1222 to agree a deferral of any tax due*
  - HMRC can use their discretion to allow you to pay any existing tax bill over a period (could be Corporation Tax, VAT, PAYE).
  - It is suggested to speak to HMRC shortly (one or two weeks) before tax is due to agree a Time To Pay (TTP) arrangement and HMRC have set up a dedicated helpline to call (0800 024 1222).
  - HMRC will want to learn more about the situation, understand the reasoning for using TTP and how you will repay the tax in the future
  - Arrangements to date have included installment payments, suspending debt collection or stopping penalties and interest if difficulty to pay as a result of Covid-19.
  - TTP only covers a specific tax liability and expects that all future tax liabilities are paid as they fall due - so if another tax liability is approaching you will need to engage HMRC again.

## Existing Loans

- **Key Points**
  - *Speak to lender and agree new terms*

- Speak to the lender and negotiate an agreement. Options could include:
  - Capital repayment holidays
  - Covenant waivers
  - Accrued interest
  - Extending the term

### Hire / Leasing

- **Key Points**
  - *Stop payment*
  - *Communicate with lessor*
- Apply for a postponement of payments for any hire purchase or leases.
- For company cars, the benefit in kind charge (for employee and employer) can be reduced during lockdown by making the car 'unavailable' (e.g. by handing the keys back to the employer).

### Other creditors

- **Key Points**
  - *Stop payments*
  - *Communicate with creditors*
- Need to be reviewed on a case by case basis.
- Retainers / recruitment / advertising / marketing / subscriptions / security / facilities management / maintenance / capex can all be stopped.

### Other thoughts

### Financing options

There are a number of potential financing options available to a business which can be considered. However, if a business is cocooned then the business owner / director should take advice before proceeding:

- The Coronavirus Business Interruption Loan Scheme offering loans of up to £5 million for SMEs through the British Business Bank – see resource center for more details. This may not be relevant for businesses if the directors can't be confident that the business will be able to repay this in the future.
- High street banks are offering additional support for small businesses
  - Lloyds - <https://www.lloydsbank.com/business/coronavirus.html>

- NatWest - <https://www.rbs.com/rbs/news/2020/03/natwest-pledges-p5bn-working-capital-support-for-smes-during-cor.html>
- Barclays - <https://home.barclays/news/2020/03/supporting-our-customers-and-clients-impacted-by-coronavirus-co/>
- HSBC - <https://www.hsbc.co.uk/help/coronavirus/>

### **Other thoughts / considerations which may be relevant**

- Self-employment Income Support Scheme
  - Relevant for self-employed.
- Self-assessment payment deferrals
  - Payment due on 31 July 2020 now deferred until 31 Jan 2021.
- Universal Credit
  - If staff are receiving Universal Credit and their income changes as a result of being furloughed, then UC payments may change
  - We have a guide to Universal Credit please contact us if you would like a copy.
- Tax refund
  - Change of accounting period to accelerate trading losses (assuming the business made a loss in the most recent period) so a corporation tax refund can be made.
- Working from home allowance
  - People who have to work from home may be able to claim back additional household costs such as utilities from the government Home working costs which can be claimed back.

### **Do you need to declare your company (ltd) dormant?**

No. Companies are only declared dormant if they don't have any material transactions during the entire financial year.

### **Should I be worried about wrongful trading?**

Wrongful trading is where the directors of a company continue to trade where there is no reasonable prospect of being able to pay the creditors which are being incurred.

In this instance the directors can become personally liable for creditors if they are found to be wrongfully trading. This is something which directors should consider given the changing trading environment.

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<https://www.dpcaccountants.com/>



However, on 28th March there was a relaxation in the wrongful trading regime meaning that from 1st March 2020 for 3 months the wrongful trading provisions are suspended meaning that where a business is nearing insolvency, directors can continue to trade and incur liabilities with no threat of personal liabilities.

Having said that, there are still a number of regulations which directors need to be aware of, not least in the Companies Act 2006 where the directors should act in the interest of the creditors where there is a heightened risk of insolvency.

To protect the directors they should prepare business plans and forecasts (outlined earlier), document decisions made at board meetings and document that the decision to continue trading was reviewed regularly.

**Contact us if you would like to discuss how your business survives the Pandemic and what actions you need to take. We are here to support you.**