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Technology and Innovation

Why Do the Warning Signs of Business Failure Get Missed in the IT Sector

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Biography

Nick Hood is the Senior Business Adviser at the Opus Business Advisory Group (https://www.opusllp.com), the largest independent advisory, restructuring and insolvency firm in the UK.

Nick was a licensed Insolvency Practitioner, working in the business rescue market for 25 years. He is a committed internationalist, having created the largest global network of independent business rescue firms and having also worked overseas in Canada, Milan and Bahrain.

In his earlier career and after qualifying as a Chartered Accountant in 1970, Nick held senior executive positions in major companies in the construction, engineering and media sectors, as well as working for a boutique investment bank.

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Abstract

All company failures are preceded by red flag indicators: some financial, others operational and strategic. To adapt Claudius in Hamlet, when business sorrows come, they come not single spies, but in battalions. Spotting them, accepting the issues they signify and taking remedial action should all be achievable in theory, but in practice commercial life is never that simple. In this article, the author explores these warning signs and looks at why they are often overlooked in the IT sector.

Introduction

Business failures in the IT sector often stem from insufficient financing, inadequate strategic planning, ineffective management, and a lack of responsiveness to evolving market trends. These factors can result in technology solutions that fail to align with business objectives, internal resistance to change, and ongoing operational inefficiencies. Early warning signs – such as declining performance, employee feedback regarding system shortcomings, and continued dependence on outdated manual processes – are frequently overlooked, leading organizations to face critical issues reactively rather than addressing them proactively.

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For example, business collapses reached an all-time peak in the UK in February 2024 and whilst currently a little lower, they continue to highlight the reality that failure can trip up even experienced leaders. Picking up the tell-tale signs sufficiently early and taking the appropriate corrective measures is crucial if insolvency is to be avoided.

In the current rapidly changing business environment and amid such geopolitical uncertainty, adaptability and resilience have to be core characteristics, but even well-established companies can find themselves struggling when they're not sufficiently alive to fundamental threats, either from inside their organization or from outside factors beyond their control.

So, where can these issues be found lurking in the fabric of an IT business?

Cash flow challenges

'Cash is King' may be an old management mantra, but it remains true. Recurring cash flow problems, especially when payments consistently exceed receipts is an obvious early warning signs of business distress. Lending facilities in the UK are usually short term and often inflexible, so initial issues over meeting immediate liabilities can escalate rapidly into a full-blown crisis, leading to:

- payments to suppliers and service providers having to be delayed;
- increasing reliance on overdrafts or short-term loans;
- difficulty in meeting payroll obligations and essential operational costs;
- deferring rent payments; and
- struggling to meet PAYE and VAT liabilities to HMRC on time.

Ignoring cash flow issues not only affects supplier and employee confidence but is likely to limit access to trade credit, resulting in a downward spiral that is difficult to stop, never mind reverse. Using HMRC[1] as an involuntary source of extra credit is a particularly dangerous strategy.

Rising debts and creditor pressure

Another key indicator is an unsustainable build-up of debt. If a business is regularly juggling various forms of credit such as bank loans, credit card facilities or supplier payments, it means that there are underlying weaknesses in the business model. Examples are:

- having to ask suppliers to accept later payment or increase their credit limits;
- regularly bumping up against bank or supplier credit limits;
- persistent collection pressure from HMRC or other creditors; and
- having to use unencumbered Company assets as collateral for emergency funding.

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Creditor pressure soon escalates into legal action, such as County Court Judgments (CCJs) or Winding-up Petitions. These are on the public record and their existence can irreparably harm a Company's reputation and therefore its ability to operate normally. Dealing with creditor enforcement action[2] effectively and quickly is vital.

Failing financial ratios and inadequate management information

Even before cash runs out, warning signs often surface in a Company's financial ratios. Declining gross or net profit margins, increased debtor or creditor days and deteriorating liquidity ratios should set alarm bells ringing.

In addition, inadequate management information, such as out-of-date accounts, unreliable budgets or inconsistent reporting, will mean that Directors are flying blind, incapable of making properly informed decisions. Examples are:

- irregular or delayed management accounts;
- overly detailed or too simplified management accounts;
- unexplained major variances between budgets and actuals; and
- going concern audit qualifications from external accountants.

Major customer defections and declining sales

A meaningful drop in revenue generation is another classic red flag. It could be caused by evolving consumer preferences, by competitors or it might mean market saturation, but whatever the reason declining turnover is often the first clear warning of fundamental strategic or operational issues. Indicators could be:

- the loss of longstanding or high-profit or margin customers;
- negative market feedback;
- adverse social media comments; and
- reduced repeat business or renewal rates.

Low staff morale and rising staff turnover

Ignoring the human element of a business is an ill-advised approach. Staff behaviours are a leading measure of organizational health. Elevated staff churn, embedded absenteeism and declining morale often tell of wider problems throughout an organization. Factors include:

- key employees resigning unexpectedly and leaving before replacements have been recruited;
- payment of wages or pension contributions being delayed;
- Increasing complaints or grievances lodged with HR; and
- market rumours of low staff morale.

The impact of a disaffected workforce for a struggling Company is compounded by the current skill shortages in a tight labour market and by both the current employee protections and the measures promised by the new Employment Rights Bill[3], which will restrict employer flexibility on staff matters.

Operational inefficiencies

Chronic bottlenecks, such as delayed deliveries, unfulfilled orders or rising wastage can directly affect customer satisfaction and Company profitability. Signs are:

- persistent stock shortages or excess inventory;
- escalating production costs and declining margins;

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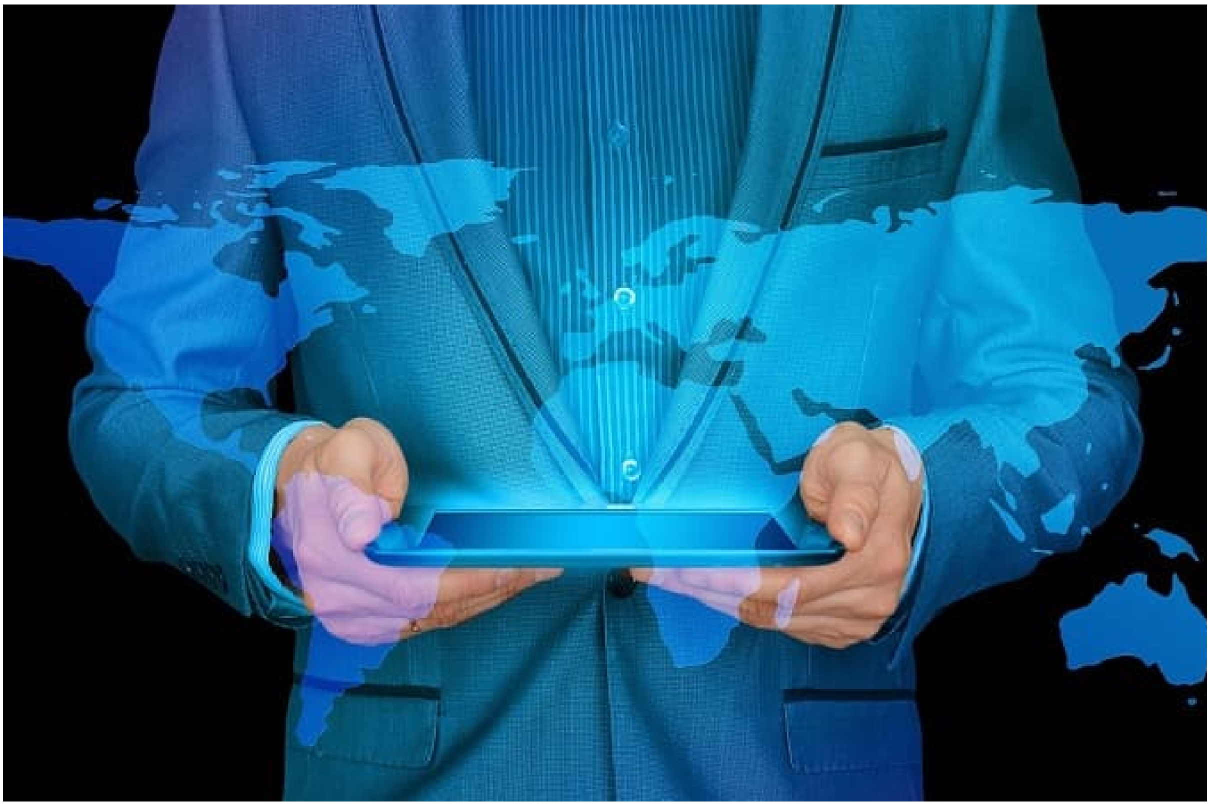
- declining product or service quality; and
- increasing customer complaints.

These issues may signify deeper structural problems, including inadequate investment in technology or a failure to adapt to market changes. There are rarely short-term solutions and applying them in a distressed business can be extremely problematic.



Loss of competitive advantage

If a business is losing market share to more agile, innovative or lower-cost competitors, it could indicate that its value proposition is no longer compelling to its customers. Causes can be:

- stagnant product development;
- unwillingness to invest in digital transformation and technology such as AI; and
- negative press or industry reputation.

Businesses that fail to respond to competitive threats risk being marginalized, especially in fast-moving sectors like retail, hospitality or fintech.

Litigation

Legal disputes with customers, suppliers, regulators or employees can be both a warning about and a cause of business distress. If such disagreements go to Court, that puts them in the public domain and may deter customers, suppliers, lenders and investors. It's important to be aware of:

- ongoing or frequent litigation, both inbound and outbound;
- negative media coverage or online reviews and comment; and
- being subject to regulatory investigations or fines.

Dealing with the problems

From a commercial standpoint, spotting the warning signs is just the beginning of the rescue act. Proactive and decisive intervention needs to follow without delay. Directors need to be constantly aware that they have a statutory duty to act in the best interests of creditors when a Company is insolvent or threatened by insolvency. This includes:

- getting and taking independent professional advice;
- dealing with pressing creditors early to negotiate settlement terms and stabilize relationships;

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- constantly revisiting business plans and exploring restructuring options; and
- prioritizing clear and transparent communication with staff and other stakeholders.

Ignoring the situation can lead to accusations of Wrongful Trading[4] and potential personal liability for Directors, as well as Disqualification[5].

Why are the flashing red lights missed?

Even for those in the often fast moving IT sector, the fog of poor management information and opaque internal communication are often key reasons why companies hit the insolvency iceberg, but at the root of most collapses is the flipside of the entrepreneurial spirit. Terminal problems are judged to be solvable, or they are either denied or ignored altogether. Blue sky thinking is a deeply dangerous management strategy when things are going badly wrong. The ostrich posture should be avoided at all costs.

It's no accident that while the legal formalities of most insolvencies are initiated by the Directors, the trigger is almost always external, for example by a lender refusing to increase a facility or pulling it completely, by credit insurers withdrawing cover or else by a key supplier asking for cash up front. It's a tragic commentary on UK business leadership that it has to be told too often by others when to stop, rather than admitting there's no way forward.

The reason this matters so much is the stark reality confirmed by research published in December 2024 by the Insolvency Service into the outcomes from Creditors' Voluntary Liquidations[6], which showed that the median recovery by creditors across 2,717 CVLs was precisely zero. The inescapable conclusion is that Directors leave it too late to take action when their business is in trouble and that the creditors pay the price for their tardiness.

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