How do companies go bust?

KS3 KS4 Ages 11-16 ⏰ 3 min read

Woolworths. Blockbuster. Debenhams. Thomas Cook. Big, famous companies that millions of people used every week — and then suddenly they were gone. How does a huge company with thousands of employees just... stop existing? It's not as mysterious as it might seem.

The basics: spending more than you earn

A company goes bust when it can no longer pay its debts. This sounds simple, but it can happen for all sorts of reasons. Maybe sales dropped and income fell. Maybe the company borrowed heavily to expand and then couldn't keep up with the repayments. Maybe a competitor came along with a better product and stole all the customers. Often it's a mixture of all three.

The technical term is **insolvency** — when the money you owe exceeds the money you have or can reasonably expect to earn.

Think of a company like a bathtub. Money flows in through the tap (sales and income) and out through the plughole (costs, wages, loan repayments). As long as the tap runs faster than the plug drains, you're fine. But if the tap slows down — or someone opens the plug wider — you eventually run dry. When the bath is empty, the company is bust.

What actually happens

When a company can't pay its bills, it has two main options. The first is **administration** — where an outside firm of specialists takes over the company and tries to rescue it, either by selling parts of it, finding a buyer, or restructuring the debts. Lots of well-known brands have been "saved" through administration.

If that doesn't work, the company goes into **liquidation** — everything is sold off (the buildings, the stock, the equipment) and the money raised is used to pay back creditors (the people and organisations it owes money to). Staff lose their jobs, and shareholders lose their investment.

Who gets paid first?

When the assets are sold, there's a strict pecking order for who gets paid. **Secured creditors** (like banks who lent money against specific assets) get paid first. Then come employees (for unpaid wages and redundancy), then other creditors. **Shareholders** are last in line — and usually receive nothing.

Does it affect customers?

If you have money tied up with a company that goes bust — a holiday booking, a gift card, a deposit — you might lose it. Some situations are protected: bank deposits up to £85,000 are guaranteed by the government. But if you've pre-paid for a holiday with a company that collapses, your best chance of getting money back is usually through credit card protection (Section 75 of the Consumer Credit Act, for purchases over £100).

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