

STATUTORY RESPONSIBILITIES

In holding a position within a corporate structure - as a Director or Company Secretary or deemed officer - you are considered by the Courts to be totally conversant with the responsibilities which that position holds, as outlined under the Corporations Act, Income Tax Assessment Act or other legislation relevant to your business. The fact that you hold this position and the work is conducted by a person other than you does not exempt you from your responsibilities.

CONSEQUENCES OF INSOLVENT TRADING

The consequences of insolvent trading for directors may give rise to the director being exposed to civil & pecuniary penalties. Also, where the company acted as trustee for a trust, directors may be liable for any unpaid debts where the right of indemnity from the trust is deficient.

BOOKKEEPING

It is essential as part of business survival to keep adequate books and records.

This obligation to keep records of financial transactions extends to transactions undertaken as Trustee of a Trust.

THE CORPORATE ENTITY AND INSOLVENT TRADING

It is important if you are a Director, that you are well aware of the provisions of the Corporations Act. In particular, a Director's duty or obligation to prevent insolvent trading by a company is detailed in the Corporations Act.

THE INDIVIDUAL

When trading in a partnership or as a sole trader, you are personally liable for all of the debts that the business incurs, and accordingly any personal assets that you have are at risk in the event of business failure.

PATTISONS provides advice on:

- Business Restructuring
- Company Restructuring
- Corporate Insolvency
- Credit Control Procedures
- Creditors Meeting
- Creditors Rights
- Debt Recovery
- Debt Security
- Dispute Resolution
- Forensic Accounting
- Insolvency Administrations
- Litigation Support
- Personal Insolvency
- Pre Lending Reviews
- Problem Debt Reviews
- Problem Loan Reviews

Pattison Consulting Pty Ltd

ABN 24 434 194 066
ACN 079 638 501

- Level 14
461 Bourke Street
Melbourne Vic 3000
Tel 03 9600 4611
Fax 03 9602 5007
DX 562 Melbourne
- Level 6
329 Thomas Street
Dandenong Vic 3175
Tel 03 9792 5611
Fax 03 9792 5822
DX 17527 Dandenong
- Level 2
83 Moorabool Street
Geelong Vic 3220
Tel 03 5222 7422
Fax 03 5222 5822
DX 22028 Geelong
- Level 57
MLC Centre
Martin Place
Sydney NSW 2000
Tel 02 9236 7319
Fax 02 9236 7320
- Level 30
AMP Place
10 Eagle Street
Brisbane QLD 4000
Tel 07 3303 0295
Fax 07 3303 0296

- www.pattisons.com.au
- pattisons@pattisons.com.au

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WHY DOES A BUSINESS FAIL?

There are three common and important principal reasons for a business failing to succeed:

- Poor Management
- Poor Liquidity
- Unprofitable Trading

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BUSINESS ADVISORS & INSOLVENCY SPECIALISTS

INTRODUCTION

Pattisons is often requested to assess a business when it is unable to pay its debts as and when they fall due.

At this stage, it may be too late to implement corrective strategies, resulting in Bankruptcy, Liquidation, Voluntary Administration, Deed of Company Arrangement or Receivership.

By seeking early assistance, strategies may be implemented to save the business, including:

- Accurate costings
- Expenditure Review
- Refinancing Proposals
- Suitable restructuring of the business organisation

A typical example of poor management or lack of business skills, is the confusion drawn between cash flow and profit eg. some Directors or Proprietors become overawed at a substantial bank balance, not fully understanding that the funds are required to pay creditors e.g. 7, 30 or 60 days.

Seeing such large sums in the bank account they tend to dabble with those funds for their own benefit or buy capital assets without providing for creditors' outstanding accounts. This activity creates liquidity problems and subsequently, failure if it is not properly controlled.

REASONS FOR A FAILING BUSINESS

- Poor Management
- Poor Liquidity
- Unprofitable Trading

POOR MANAGEMENT

Good management of a business is an indication of its ability to identify real or potential problems, and to take the necessary corrective actions.

Poor management may arise due to the lack of knowledge and expertise in a specialist area of the business.

Poor management may be classified as either External or Internal factors.

External Factors Leading to Poor Management

The following list outlines factors beyond the control of a Director or a Proprietor that must be managed correctly to ensure business survival:

- Changes to the law
- Family reasons
- Government restrictions
- High borrowing costs
- Inflation
- Interest rates
- Market forces
- Matrimonial disputes
- Negligent advice
- Poor economic conditions
- Poor external advisors
- Shifting populations
- Taxation
- Unions

Internal Factors Leading to Poor Management

Understanding that external factors cannot be controlled, but must be managed correctly, the Director or Proprietor needs to understand the following internal factors that may affect the success or failure of the business(es):

- Budgeting and forecasting procedures
- Changing consumer demands
- Costing/quoting procedures
- Credit control
- Financial/accounting knowledge
- Holding costs
- Increased unserviceable debt
- Knowledge of statutory regulations
- Management salary levels
- Margins
- Marketing strategies for products/ services
- Need for adequate insurance
- Need to be able to replace terminally ill or deceased senior staff
- No succession planning
- Poor cash flow
- Purchasing practices
- Record keeping
- Site control
- Supervision of staff and sub-contractors
- Staff training
- Stock control
- Unsatisfied demands for payment

POOR LIQUIDITY

Sources of funds available to contribute to the liquidity of the business are:

- Funds from shareholders in respect of share issues and profits retained in the business ("Shareholder funding")
- Funds from proprietors in respect of capital injected ("Proprietor funding")
- Asset realisations i.e. collection of book debts or disposal of assets ("Asset realisations")
- The supply of goods from creditors prior to any payments being made ("Creditor funding")

Shareholder Funding

Shareholder funding may result from issued capital or profits retained. The level of capital funding needs to be sufficient to support the activity levels of the business.

A company needs to maintain its liquidity requirements from its own resources and if necessary profits retained in the business.

A company's profitability is affected by its margins, asset utilisation and gearing.

Low Gearing

A low gearing ratio occurs where there is a low proportion of funds provided by outside lenders compared to shareholder funds.

If the business does not have a high debt activity, these businesses have a high capacity to absorb problems which may arise e.g. a bad debt write-off or seasonal downturn in the industry.

High Gearing

A high gearing ratio occurs when there is a high proportion of funds provided by outside lenders compared to shareholders funds, i.e. the company has a high debt servicing commitment.

Lack of profits or a diminishing level of activity may result in a reduced capacity to absorb any liquidity problems, which may arise.

A highly geared company needs to ensure that it does not have idle assets (e.g. stocks and book debts), in order to meet debt repayments out of its own cash resources as and when they fall due.

Proprietor Funding

This type of funding is provided by a cash injection from the proprietor of the business.

Insufficient initial or ongoing cash resources to finance establishment costs, including plant and equipment purchasing, and the inability to finance projects prior to receiving any funds from customers/clients, may cause a business to fail before it has really become operative and self funding.

Asset Realisations

Idle assets may cause a deterioration of the profitability or liquidity of the business, and as such should be quickly realised.

Proper stock forecasting and tight controls over stock purchasing and rotation overcome idle stock asset build up.

Inventory problems may not only arise in relation to actual purchases of goods or materials to be used on jobs, but also the amounts outstanding for work in progress. Progress payments due for work done should be submitted as soon as practicable to prevent funds from being withheld unnecessarily.

Book debt collection should be tightly controlled and their ageing limited, in the event that the customer breaches the agreed credit terms, strict credit control procedures should be enforced.

Creditor Funding

Many businesses rely heavily on the support of their trade creditors to finance their business activities. It is necessary to ensure that agreed credit terms are maintained.

Issues involving creditor funding include the overspending or incorrect purchasing of items. This can lead to idle stocks or costs that may not be able to be absorbed by the business. As a result profits fall, creating a liquidity problem.

REMEDIES FOR A FAILING BUSINESS

- Acquire the services of a good accountant/solicitor
- Analyse variations between budget and actual costs
- Be positive in advising creditors of current cash flow or liquidity problems, keeping creditors advised of the circumstances
- Constantly review costs and arrange to have financial figures prepared regularly (at least quarterly), to assist you in management decisions
- Contact your Industry Association in respect of questions that you may have.
- Keep up to date with trends and market demands by attending trade nights, industry seminars, etc.
- Maintain and review cash flow projections
- Obtain the assistance of an industry specialist when necessary, to complete a contract or to resolve a current problem
- Regularly prepare budgeted profit and loss statements
- Seek the assistance of your professional advisors, consultants, accountants, solicitors, industry experts or insolvency practitioners
- Use prompt, corrective action in order to prevent you from defaulting under your contracts

Commitment

Responsibility Liability