Anatomy of a business collapse

It's not a fun read: that's intentional because some business owners put their head in the sand and keep it there despite red flags being waved all around. A bookkeeper tells the tale of a typical failure pattern

The lead-up to court action

Most business collapses are triggered by a creditor taking a judgment out against a debtor-company and that company being unable to satisfy the judgment (that is, to either pay it out in full or to pay a reduced amount which the creditor is prepared to accept).

However, invariably, the debtor-company will have survived a period of financial stress which will have preceded the judgment being taken out against it.

This situation will be familiar to most business owners and entrepreneurs because anyone who has built a business knows what it is like to juggle the bills.

If your business is continuously juggling, if your accounts staff are facing persistent pressure from creditors, if it is a struggle to meet the fortnightly wages, if your BAS payments to the ATO are getting paid beyond the due date, if creditors are curtailing supply and if, in bush fire parlance, you find that increasing parts of your day are devoted to putting out spot-fires rather than operating the business, then be warned.You have reached a danger point.

The bookkeepers perspective.

It's perhaps noteworthy that many of our bookkeepers at the Bookkeepers Hub www.bookkeepershub.com.au report that they are often tasked by business owners to delay or defer gst payments to the ATO. That's a hand grenade approach which will bounce back and explode in the face of the business owner.

Debra Lewis CEO of the Bookkeeping Institute of Australia says she believes that bookkeepers pay an important role. She says "A qualified bookkeeper has a duty of care to ensure that such mistakes are not made.

"They are often the first to spot the problems. Business owners should listen to what they have to say and report."

The real problem is that a business can go from being stable and secure to being at risk very quickly.

It's not the economy

The economy is rather like a bush fire which keeps zigging and zagging as the winds change and as it covers different terrain. Predicting its course and making decisions based on that prediction is a dangerous strategy. So-called 'cycles" have a habit of stalling or speeding up (increasing

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costs of funding) in unpredictable fashion; indeed, it may result in paradigm changes and these changes may severely impact your business model.

Operating a business which is under financial stress, is an unpleasant experience.

Even in good times, business failure is common.

Most business failures do not result in catastrophic failure (that is, either liquidation of a company or bankruptcy of the business owner(s). Failure in most cases results in the business shutting down and in the business owner walking away, shattered, poorer but not bankrupt.

The signs of business distress are not difficult for an observer to see.

Staff numbers drop. If it is a small business, more of the hands-on work is carried out by the owner her or himself and perhaps his/her spouse or business-partner.

If the business is a retail shop, the shelves become noticeably barer and the range and depth of stock drops off. A café cuts back on muffins (god forbid!) on the counter. Sales become lost because there is no more product of the particular size requested or there is simply not enough stock to attract the interest of customers.

It’s in the accounts

The greatest pressure is certainly felt within the accounts area because it is at the coalface of handling complaints and aggression from disgruntled creditors.

The problem is that an entrepreneur or business owner, who has devoted his/her financial resources, hopes and dreams and probably, many years of hard work, into building the business, will often just not accept reality.

Many business owners lack the business acumen required to develop a sustainably profitable business. They have the dreams but not the ability and capacity.

It is possible to keep going for several years, operating a business which has probably never been sufficiently profitable and has little real prospect of ever becoming sustainably profitable.

Creditors get pushed out, the overdraft increases, funds are raised by leasing chattels, payments due to the ATO get deferred, whilst the business owner draws out enough to live on.

The reason is that business owner of businesses which are inevitably destined to fail do not normally face reality. They do not face reality because they do not want face news which will dash their hopes and dreams.

Such people take advice selectively and hear what they want to hear and don’t hear what they don’t want to hear.

Some definitions you may not wish to know about

In debt recovery terms, the creditor is the person your business owes money to.

Debtor is the person who owes you money.

The document which is issued by the Court and which initiates legal action against a debtor by a creditor is generically called a *Writ* and specifically, in Victoria it is called a *Complaint* and in New South Wales, *Statement of Liquidated Demand*.

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For simplicity, I will use Victorian legal terms. However, each state jurisdiction has its own specific terms, although there is common over-lap. For example, a Complaint is effectively the same as a Statement of Liquidated Demand.

In most states the Court used to initiate most debt recovery claims is the *Magistrates Court.* In New South Wales, it is the *Local Court*.

Bankruptcy is taken out against an individual, whereas *liquidation, receivership and administration*, affect companies.

Default Judgment is an Order from the Court which is obtained without there being a hearing and is the most common civil order made by the Magistrates Courts.

Plaintiff or Complainant is the party who initiates legal action. If it is against your company, they would be the creditors.

Defence is a document which the company being sued must complete and lodge with the Plaintiff and with the Court if it wishes to avoid a Default Judgment being taken out against it. This will then result in a hearing date being set by the Court and in the matter being determined by a Magistrate.

Defendant is the person who gets sued.

We are grateful for Roger Mendelson proving the pre-edited version. Roger is a lawyer and founder of debt recovery company Prushka. www.prushka.com.au