

CLIENT UPDATE

■ ■ CORPORATE INSOLVENCY

■ ■ RESTRUCTURING

■ ■ FORENSIC ACCOUNTING

Business viability checklist – limiting a director’s personal liability

Privately owned Australian businesses are hurting, and we are seeing an increased incidence of non-viable businesses being propped up by the use of personal credit card debt. Whilst this strategy may extend the life of a business, it is usually short-lived and inevitably leads to the demise of the corporate entity, as well as the personal insolvency of its directors. With this in mind, we have prepared a brief checklist of critical non-financial matters to consider when assessing the viability of a business experiencing financial distress.

Director Resistance

In our experience, directors of privately owned businesses are often reluctant to take independent advice on issues such as business viability, rationalising that an outsider could not understand the intricacies of their business.

The instinctive optimism of an entrepreneur can also blind a director from the realisation that their business is in financial trouble.

...alarming trend of non-viable business being supported by personal credit card debts

Regrettably, this resistance, combined with the fear that the collapse of the company will lead to unemployment, has seen many nonviable businesses continue to trade in circumstances where they should not.

Determining business viability

We have prepared a checklist of critical non financial questions that should be answered prior to the directors investing further monies into an ailing business. These questions are not tough to answer, but the answers may be difficult to accept. The faithful completion of this checklist should help directors decide for themselves when their business has gone too far and in doing so, help avoid the temptation of propping up their business with readily available credit card debt.

Is there a demand for the product or service being provided?

Focus on existing customers. Is there enough current demand?

How much are clients willing to pay?

What is the price required to make a profit at the current level of demand? Can the business make sufficient sales based on that pricing?

How often will customers purchase?

Is the product or service a staple that must be purchased or a discretionary product? Are there alternative suppliers of the product or service?

Does the company have a genuine competitive advantage?

Why does a customer purchase this product from you? Is that truly unique and sustainable? What is your position in the market?

Can the business afford to continue to purchase the essential raw materials?

What is the age of critical suppliers to the business? Are key suppliers owed debts aged 60 days or more?

Do the owner and key staff have the skill to manage the business?

Identify the staff that are critical to income generation. Is their employment secure? Can management rely on the internally maintained accounting information to make critical business decisions?

If the business being assessed is struggling financially, and the business owner is unable to answer these questions positively and with conviction, the indicators are the business is not viable and exit options (sale or merger or close down) should be seriously considered. If the business owner is considering borrowing more money to invest in the business, they must think again, and take a pragmatic approach, ensuring their faith in the business is not misplaced.

Of course, if the answers are also negative and the company does not have the capacity to pay its debts as and when they fall due, insolvency advice is appropriate.