

City of Port Phillip

Business Forum

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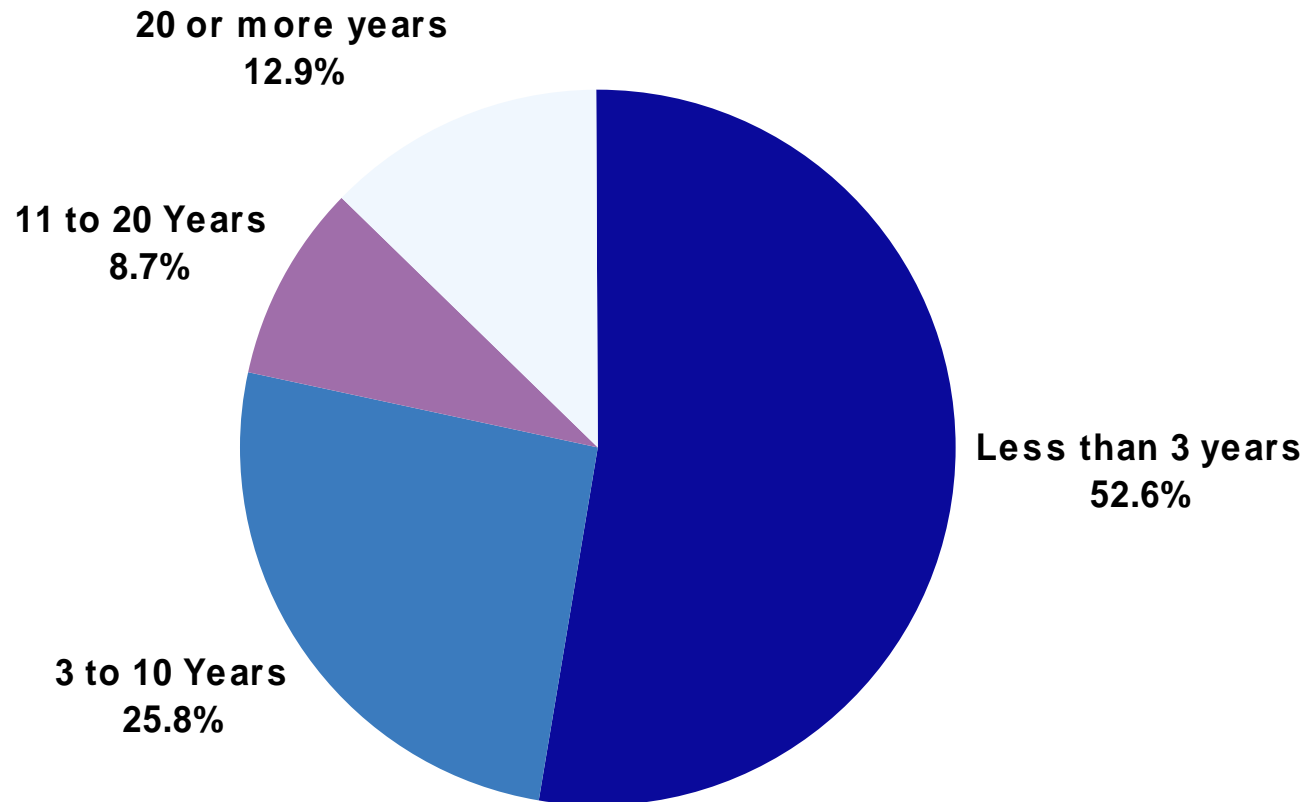
What you are up against

	Peak	July 2008	30 January 2009
■ US\$	0.99	0.97	0.64
■ Dow Jones	14,164	11,000	8,000
■ All Ordinaries	6,853	5,000	3,479
■ Oil	\$154	\$130	\$41



New business failure

Age of Business Failures:



Source: ABS

Introduction

- **Part A**

- Most common reasons for business failure

- **Part B**

- Signs & symptoms of business failure



Part A

Common reasons for business failure

Three most common factors for failure

- Lack of liquidity
- Lack of profits
- Poor management

Part B

Signs & symptoms of business failure

Causes of failure: Macro issues

- Industry
- Economy
- Technology / PS2 / Wii
- Competition
- Legal, political and social issues
- Changes in markets

Industry

- In decline – “twilight industry” eg, video stores, music retailers (not online), telco retailers
- Industry consolidation eg. hardware stores, pharmacies, food processing
- Too expensive/not practical to produce anymore (particularly domestically)
 - Clothing and textiles (shoes)
 - Automotive (suspension bars)
- Obsolescence or substitution
 - TV and print media versus Internet
 - Travel agents
 - Printed brochures/newsletters/invitations now non existent with law & accounting firms

Industry

- Struggling due to economic factors
 - Transport
 - Retail
 - Building and construction
 - Independent petroleum retailers due to growth of Coles and Woolworths distribution
 - Inbound travel due to \$AUD

Economy

- Change in economic conditions eg consumer spending down
- Boom or bust cycles eg property, mining
- Domestic and foreign conditions, eg exporters exposure to Asia, oil prices
- AUD fluctuations
- Particular economic factors eg interest rates – eight rate rises in three years, now the reverse
- Economic policy eg tariff protection, tax concessions
- Availability of credit
- Changing equity markets

Technology

- Product obsolescence in the absence of re-invention eg. gaming platforms
 - Nintendo
- Money tied up in obsolete machinery, rapidly losing value – printing industry
- Alternative machinery or processes, losing ability to compete
 - Cheaper production
 - Better quality

Competition

- Cheaper imports, particularly dumping of products – fragrances/toiletries
- Low barriers to entry
- New or bigger player trying to buy market share eg:
 - Hardware
 - Pharmacy
 - Retailers
 - Aldi
 - Costco
 - Stationary suppliers

Legal, political & social issues

- Social trends eg smoking in pubs, clubs and gaming venues
- Economic policies eg tariff protection for cars or stamp duty increases on luxury vehicles
- Laws eg. Environmental obligations on mortgagors
- Political/Government policies eg government spending, privatisation, toll roads, gaming industry changes

Changes in debt markets and stock market

- Credit “crunch”
- Price of debt
- Availability of equity – dried up
- General uncertainty
- Knock on effects to economy/industry/transactions – especially building and construction
- Collapse of world equity markets

**Early warning signs
regardless of industry
“the micro issues”**

Early warning signs – micro issues

- Directors/Owners/Management
- Accounting/Information
- Business Fundamentals
- Overtrading

Directors / Owners / Management

- Issues to consider:
 - Lack of clearly defined business objectives, plans or strategies
 - Skill-set – relative to business
 - Experience – start up
 - Involvement – too much/little
 - Lifestyle
 - House/cars
 - Out of proportion to size of the business
 - Ambition – exceeds ability
 - Succession – lack of it or based on blood lines
 - Lack of organisational structures

Management / Staff

- High turnover of key executives
- Weak finance/management team
- Loss of key management
- Lack of management depth
- Lack of enthusiasm / care
- Management too old or too set in their ways
- Bad feel about the place, ie:
 - Failure to return calls to supplier and bank
 - Demeanour of staff
 - Lame excuses

Accounting / Information

- In particular, the absence of:
 - An understanding of the primary information – cash v profit
 - Qualified staff
 - Sufficient systems (industry specific if necessary)
 - Budgetary control – variance analysis – is any done?
 - Costing systems
 - Lack of recognition of freight costs
 - Omission of indirect material costs
 - Failure to allow for scrap
 - Realistic valuation of assets

Accounting / Information

- ❑ Creative accounting
 - Capitalisation of costs - impact on balance sheet
 - Lack of accrual accounting
- ❑ Timely financial information and reports – segment/divisional reports
- ❑ Effective management of cashflow
 - High incidents of last minute requests for urgent temporary bank accommodation
 - High incidents of bad debts, no routine ageing of debtors, customers seeking repayment plans
- ❑ Effective working capital management
- ❑ Clearly defined marketing strategy – lack of a plan
- ❑ Imbalance in product range
- ❑ Credit control

Accounting / MIS

- Unreconciled differences between:
 - Management accounts
 - Financial statements
 - Tax returns
- Is management data checked against externally prepared data of suitable quality of the size of the business – ABS, IBIS, Industry Groups
- Poor planning and/or poor reporting that monitors progress against plan/projections usually leads to failure or, at least, lost opportunities

Business fundamentals

- Increased ageing of creditors (eg paying late or not at all)
- Paying creditors in round amounts and instalments
- ATO arrears
- Deteriorating key ratio's (eg poor liquidity)
- Increase in warranty claims
- Major legal actions/default judgements
- Cheques in drawer

Business fundamentals

- High incidence of credit notes (poor product/sales false)
- Dependent on a few large customers or loss of key customers
- Regularly exceed overdraft
- increasing need for sales or discounting
- Bank covenant breaches
- Declining stockturns
- Reliance on Goodwill or IP to keep balance sheet positive

Overtrading

- Business growing faster than internally generated cash flow allows
- Often occurs when business is immature
- Lack of working capital
- Stretches IT systems

Structure

- Complex
- Tax driven
- May be an attempt to distance Bank (eg impact on security)
- Relative to other industry players

Outside forces

- Receipt of statutory demands
- Director penalty notices – Section 222 AOE Notices
- COD arrangements
- Legal actions taken by creditor
- Diminishing market share or price wars
- Physical deterioration in the appearance of the business premises

Financing

- Highly geared
- Inappropriate financing (eg everything leased and finance not appropriate, ie factoring)
- Maturity of fixed term borrowing without plans for repayment
- A reluctance of management to accept or plan for general economic conditions that affect them eg exchange rate movements, interest rate movements

How should early warning signs be managed?

- Quickly!
- Don't ignore them. Denial will most likely lead to loss
- Understand what has changed i.e. what is the cause of the change in circumstances
- Be realistic in preparing assumptions for a turnaround
 - Promise little – deliver more!!
 - Seek help
 - Don't let the turnaround consume the business – Generally not equipped to fix a problem
- Once the warning signs have been identified and confirmed, set a plan of action to correct it. Then monitor the plan
- Speak to your banker, don't hide problems, deal with them

Closing thoughts

- Cash is king!
 - Prepare your accounts
- Understanding your business is critical!
- Be prepared – now and for the future!
- Seek advice!
- History has a habit of repeating itself!

Key contact



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