

So Really; Why do Businesses go Insolvent?

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It is during times like these when a financial crisis begins to take significant effect that many people start to focus on the fact that businesses do actually go broke. Much of the spontaneous blame is on the basis of the economic climate.

However this could not be further from the truth. It is public but not necessarily common knowledge that 80% of businesses fail in the first five years. The problem is that during a financial crisis the effect is more evident because you are counting on them paying you money.

A report published by ASIC¹ showed that during the financial year 2010–2011 the largest cause of company failure at 44% was related to “poor strategic management of business”; by comparison with 2008-2009 which was 43%. The actual reasons are many and varied and are based on only companies and the report is generated from input based on a finite number of options.

Let’s focus on four of the more common reasons for business failure.

Poor Management Skills

Just because you are a respected expert gardener, mechanic, salesman, IT guru, accountant, lawyer or whatever does not make you a leader in business. Management is the ability to coordinate resources, both physical and human and coordinate them in such a way so as to provide a profitable result.

If you don’t have such skills then do the learning before you start your business otherwise you will be a statistic.

Insufficient Capital

I acknowledge you can set up a company with \$2 in Share capital, in fact these days it’s actually \$1, but rest assured this is not enough to actually run a company, it’s not even enough to run a business without a company structure! By way of example; many years ago I watched four intrepid young men make a lot of money when the ferry first started to operate to Parramatta. The passenger queues were long, the weather warm, the wait long and there was not a water bubbler to be seen. These four intrepid school boys on Christmas vacation rode their bikes to the local Supermarket, bought a carton of cheap soft drinks each and sold them warm for a \$1 a can. An initial outlay of only \$40, and then spent the remainder of the day going backwards and forwards to the supermarket when their box was empty and getting another one.

Nothing comes for free so make sure you have enough money to either buy, or finance, what you need to start up and to cover the working capital during the establishment period.

Lack of a Plan

If you don’t know where you are going then you’ll never know if you ever got there! You must start off with the basics of a good plan, just a few simple pages that enables you to get your thoughts together and more importantly impart such information onto others.

It needs to cover who, when and how as well as the basic outline of your initial financial plan. It should be in language that you clearly understand and can readily and intelligently link back to your actual activities.

¹ <http://www.asic.gov.au/asic/asic.nsf/byheadline/11-263MR+ASIC+report+provides+overview+of+corporate+insolvencies?openDocument>

Remember my intrepid boys, if you thought day one was a wonder then day two was a pearler!! The boys returned on the second day but this time there were 4 bikes, two tubs and a supply of ice. Two of the boys ran the supply run, one managed the stock and cash and one handled sales, a plan and a business. This essentially went on for three weeks until Sydney Ferries (SF) sold a concession and booted the boys off.

Whilst their foray into business was short I dare say it was very profitable and if the impending return to school had not interfered then maybe they would have negotiated with SF.

Failing to Read the Market

In business you are at the whim of the market. If you do not provide good service, think the customer is king, don't know where your market is and what your competitors are up to then you will fail.

This is an ever evolving process and takes considerable effort. Ensure that you have good advisers and most importantly ensure that you genuinely do have the demeanour to be the operator and customer focused person that you must be.

If you don't your customers/clients will see through you in due course and your business will fail.

So as you can see it's not easy but it can be simple, know what you are getting into and how you are going to go about it and you should do reasonably well. But remember its hard work; there are no free rides in business.