Business Failure
Prevention is Better than Cure

By Irial O'Farrell

In difficult economic conditions and with cash in short supply more companies are struggling for survival. The advice of accountants in practice can critical in ensuring survival but struggling companies are not always ready to hear good advice. Irial O'Farrell has some practical tips to help practitioners cross challenging communication hurdles.

Cash is a funny old thing. Usually classified as an asset on the balance sheet, it becomes a rather serious liability when it runs out. The reasons companies run out of cash may vary - from poor management to failure to address falling sales, but the one thing all insolvent businesses have in common is lack of cash.

The word 'insolvency'sends shivers down the spine. Nobody goes into business to fail but more and more companies are biting the bullet.

Media headlines sensationalise liquidations - the more renowned the business and the greater the number of job losses, the better the story.

Behind the headlines, the impact of business failure spreads widely. There are the employees, whose loss of identity and esteem is quickly followed by the reality of having to pay the mortgage and the bills. They may have been 'captive 'employees in that this was the main employer for 50 miles or the work was so specialised, that there is little hope of getting similar work. SR Technics springs to mind.

Then there are the creditors – suppliers, customers, utilities, landlords – unpaid bills accrued over the last 6-12 months, with promises of being paid. Some outstanding debts may be sufficiently large enough to push other creditors to the edge, causing a ripple effect within the community.

Last, but not least, there's the loss felt by the business owners. For many, their business is an extension of themselves, their 'baby', and the loss is keenly felt. The loss of all the effort and work, the loss of their income and possibly the loss of additional personal savings, invested in the hope that it would enable the business to survive. Take businesswoman, Helen, who re-mortgaged her house to the tune of €390k in September 2008 in the hope of bailing out her company. The company still folded in November 2008 and she is now in serious danger of losing her home.

Most of all, business owners must deal with the perceived badge of failure – a public record of their inability to run the company. Conor Woods, Business Advisory Partner with Russell Brennan Keane, sums it up neatly in one word, 'heartbreaking'. As if dealing with the loss is not enough, owners of the business find themselves on the sidelines of a cold, clinical process, driven by tasks and law, otherwise known as Liquidation.

At this point, everyone is looking for answers. Revenue, creditors and employees want to know what their share is. Business owners/directors want a road map of the liquidation process. According to Eammon Leahy, of Leahy & Co, they are looking for clarity around how long the process will take, what the consequences and costs are and what their personal liabilities will be.

As Woods says, 'It's in no-one's interest for an Irish-based business to go under'. Business is the life blood of the economy. Without it, there is no productivity, no jobs, no tax to fund education or infrastructure and no requirement for spin-off services and jobs'.

So, given the rapid increase in liquidations, are things likely to get worse? Research conducted by the Irish Small and Medium Enterprise Association (ISME) found that 66% of small businesses have indicated that their viability will be under threat over the next 12 months, if present conditions remain. Given that ISME has approximately 8,500 member companies, that's a lot of companies who may not need accountancy services in 2011.

So what role can accountancy practices play to prevent needless liquidations?

While larger companies typically have their own Financial Controller and can leverage monthly Management Accounts, small to medium sized companies often can't afford that luxury. Instead, they rely on annual accounts and little else to monitor financial performance and, in the current climate, they may benefit from some timely advice. Many SME business owners are not financially savvy, don't understand the difference between cashflow and revenue and, most importantly, don't automatically think of their accountant, who they associate with a once-a-year process, as a possible resource to advise them in how to deal with their difficulties.

To illustrate this point, Karl, a business owner with 20 years' experience, told me how he had scaled back and made unpleasant cuts in order to survive, based on the advice from his accountant. While the adjustments were painful, 9 months down the line, he can see that they are working and have enabled him to survive 2009. Curious, I inquired how the conversation had arisen. The accountant raised it off the back of 2008's accounts.

When asked if the conversation hadn't happened, what would he have done, Karl acknowledged he would have continued on as before until the next set of accounts were prepared, at the end of 2009. He didn't want to think what mess he'd have been in at that stage. Asked if he would have thought to go to his accountant for advice, he answered: 'No, it wouldn't have occurred to me'.

So, what can be done to help clients and protect your own client-base?

The first decision is whether this strategy is worth exploring or not. Small clients need help but may not be in a position to pay for it now. Can the accounting practice afford to take on the additional work with no guarantee of payment? On the other hand, in the medium to long-term, can the practice afford not to?

If this strategy is adopted, the next step might be to carve out time to undertake the additional work. One way to do this is to use Covey's Time Management Quadrant to classify work/tasks as 'Urgent' (to you/the practice) and 'Important', 'Urgent' and 'Not Important', 'Not Urgent' and 'Important' and 'Not Urgent' and 'Not Important' (*See Table*).

Tasks in the 'Not Urgent/Not Important'category should be stopped altogether as they don't add any value whatsoever. Tasks that fall into the 'Urgent/Not Important' category are typically tasks that are important to other people who, in turn, make them seem urgent to us. For example, non-tax return-related queries from clients during the month of October could arguably be temporarily categorised as 'Not Important' but the client might still see them as 'Urgent'.

Table 1: Covey's Time Management Quadrant Example – October 2009

	Urgent	Not Urgent
Important	Clients' Tax Returns Practice's Tax Returns Dealing with Client Queries	Documenting Procedures Strategic Planning for 2010
Not Important	Non-Tax Return-related Client Queries (October only)	Reading yesterday's newspaper

If all tasks fall into the 'Important' categories, repeat the process with an eye to what is important for you to do versus what can be delegated.

The next step might be to review the Practice's current book-of-business and sort into 'Profitable'and 'Non-Profitable' clients; followed by a second sort into 'Likely to Survive' and 'Likely to Run into Difficulty'. If the second sort is proving difficult, it might be time to touch base with each Client and find out how 2009 has been for them, which should provide a better picture

Once the two sorts have been completed, a clearer picture should have emerged in relation to the book of business and informed strategic decisions can be made. In relation to minimising avoidable liquidations, the focus should start with Clients in the 'Profitable/Likely to Run into Difficulty' quadrant, as these have been identified as important Clients to the practice and the ones most in need of help.

The final step might be to arrange a meeting to explore each client's financial situation in detail and design a survival plan. If this type of meeting is a new departure for the practice, it might be worthwhile identifying the best way to introduce it in a positive manner – is it a new, complimentary service being offered or could it be offered as a follow-up service coming off the back of the financial statements? Is it something they are interested in availing of? If this is not a service they are used to, they might not see the need.

Finally, conduct the meeting in a manner which builds the relationship and enhances trust on both sides. Most adults inherently don't like being told what to do or having what they 'should have done' pointed out to them. Starting with opened-ended questions, such as 'how have things been going over the last few months' followed by probing questions, such as 'what overheads do you feel could be reduced or removed altogether' usually gets the client talking and opens up the conversation. The aim is to listen, rather than talk, in order to gain a good understanding of the client's situation.

Once the financial situation is sufficiently outlined, the focus can move to designing a survival plan. This may take some time and a follow-up meeting to outline the plan to the client may be necessary. Many clients may not like the proposed plan, as it will inevitably involve pain of some sort. One possibility is to use a coaching question such as 'what will the impact be if the changes aren't implemented?'. The answer will probably throw the available paths into sharp relief and highlight the inevitable need to change.

In summary, business failures result in few benefits and much loss – to the business owners, to suppliers, to the employees, to the economy as a whole – and should be avoided where possible. For larger companies, they typically have their own Financial Controller and monthly management accounts to flag possible insolvency issues. Smaller companies have fewer resources to access such data and less experience in interpreting it. Accountancy practices can play a crucial role in providing such experience to these clients, adding value to the overall health of businesses in Ireland.

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