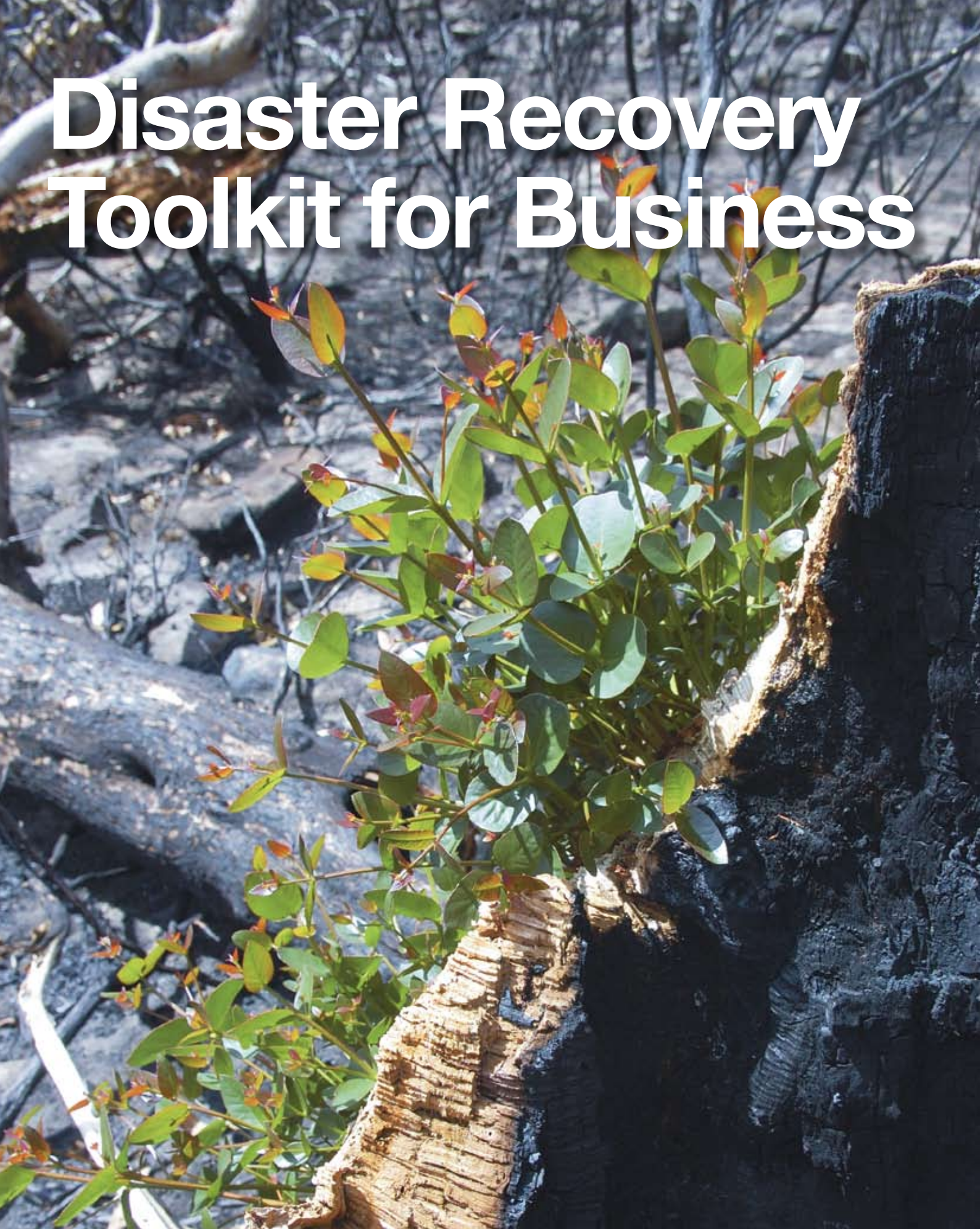


Disaster Recovery Toolkit for Business



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Acknowledgements

CPA Australia Ltd acknowledges the following for contributions of materials to this document:

- Australian Government
 - Disasterassist.gov.au
 - Australian Taxation Office
 - Centrelink
 - The Australian Securities and Investments Commission
- Victorian Government
 - Premier's Office
 - Business Victoria
 - Department of Human Services
 - State Revenue Office
- Queensland Government
 - Department of Tourism, Regional Development and Industry

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Managing a business following a disaster

Businesses may be affected by disasters directly and indirectly. For instance, businesses may not be directly caught in a disaster, but the resultant decline in trade will affect the business. This toolkit provides information to assist businesses that are both directly and indirectly affected by disasters.

Business recovery after a disaster

Getting back to business

Following a disaster, it is anything but 'business as usual' for you, your employees and customers. The faster you can return your business to some level of normal operations, the quicker you can restore your income, jobs and the goods and services you supply to your customers. However, research from the US estimates that up to 40% of businesses affected by a disaster may never reopen

The time it takes for a business to return to something like normal operating levels depends on a number of key issues:

- Overall damage assessment – can you trade from your existing premises and what stock, supplies, equipment and other key assets are recoverable and what is not recoverable.
- Your insurance coverage and how quickly your claim can be processed
- Any government assistance you can access
- Communication with employees, customers and suppliers.
- An assessment of the business's financial position
- Developing a plan to reopen your business.

Evaluating your financial position

Businesses affected by a disaster should take the time to evaluate their financial position before making decisions on whether to reopen their business and if so, how they should operate in the new environment. Evaluation of the financial position of your business is important as:

- the business may have substantial outgoings before they can restart (and therefore the business needs to know how they are going to pay for such outgoings and if they can afford such outgoings)
- there may be a significant period before the business can restart trading (and therefore the business may have to rely on existing sources of cash and other assistance until that time)
- it can assist the business make claims for insurance such as business interruption insurance, and
- the assessment will help you decide which direction you want to take your business.

To evaluate the financial position, the first step is to attempt to reconstruct your financial records (see ***Reconstructing financial records after a disaster***). The initial focus of reconstructing accounts is to determine the cash position of the business including cash at bank plus any cash inflows (from existing debtors that are recoverable, insurance payouts, government assistance and other sources) less any cash outflows (such as payments to suppliers, loan repayments and other payments).

Recovery planning

Once a business has established their financial position, the business is better placed to re-open. The next step in re-opening your business is to develop a recovery plan.

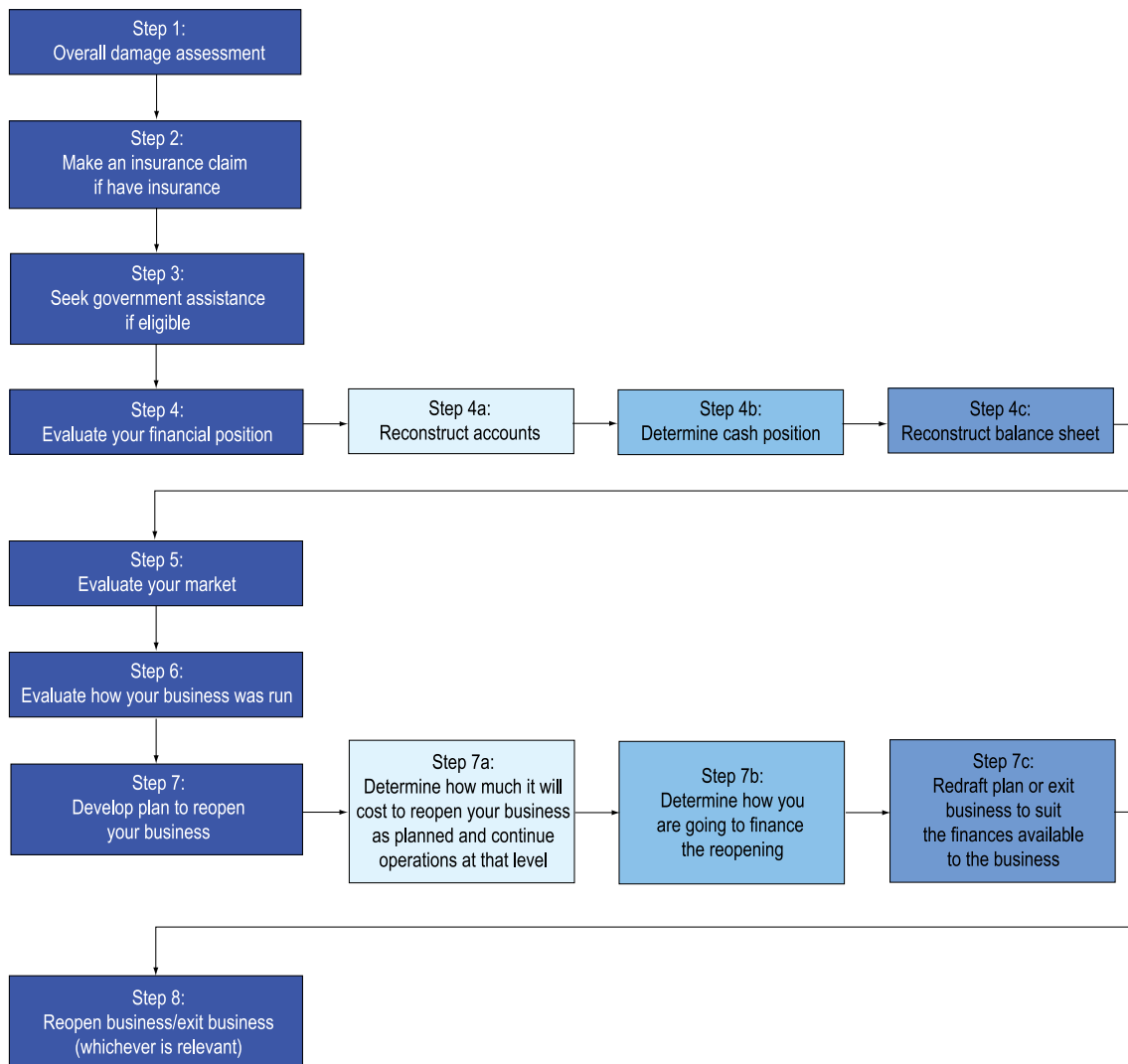
A recovery plan should state what the business needs to re-open, such as processes and resources that are critical to reopening and your recovery objectives, including actions to achieve those objectives and who is responsible for those actions. A recovery plan template is included in this toolkit.

Such a plan, together with cash flow forecasts and profit and loss forecasts will help a business determine whether it is viable to re-open and how the business is going to finance the re-opening.

In developing such a plan, it may be very difficult to make assumptions in a post-disaster environment – past experiences may no longer be relevant and the market may have changed significantly, at least in the short term. Therefore it is important to analyse your market again.

If it is difficult to finance the planned reopening, the plan may have to be modified or the business owner may have to consider exiting the business (see ***Guide to Exiting your Business***).

Steps to getting back to business



Checklist for re-opening your business after a disaster

Following a disaster, it is anything but 'business as usual' for you, your employees and customers. The faster you can return your business to some level of normal operations, the quicker you can restore your income, jobs and the goods and services you supply to your customers.

Businesses will be affected by a disaster in different ways. This checklist is aimed to assist businesses that have been directly affected by a disaster. It will lead you through some of the many issues you will need to consider before and after reopening your business.

Preliminary Assessment	
<i>Mark with a 'Yes' or 'No' when you have considered a question or tick where you have acted upon a question.</i>	
<i>Should you re-open your business?</i>	
• Were you happy running the business before the disaster?	<input type="checkbox"/>
• Were you making the profit you wanted?	<input type="checkbox"/>
• Do you prefer being your own boss?	<input type="checkbox"/>
• Have you considered other opportunities?	<input type="checkbox"/>
• Are you prepared for the potential extra demands that recovering your business will place on you, both personally and financially?	<input type="checkbox"/>
<i>Have you done an assessment of the damage?</i>	
• Are your premises operational?	<input type="checkbox"/>
• Can you recommence trading from your premise without significant repairs?	<input type="checkbox"/>
• Is any of your stock, supplies and equipment recoverable?	<input type="checkbox"/>
• Have any of your staff been affected by the disaster?	<input type="checkbox"/>
<i>What are your chances for future success?</i>	
• Have you analysed the potential demand for your product or services post disaster?	<input type="checkbox"/>
• Have any of your key customers and/or suppliers been affected by the disaster and if so, will this impact your business?	<input type="checkbox"/>
• Has the disaster lead to other businesses in your area closing and if so, have you determined how this may impact on your business?	<input type="checkbox"/>

Preliminary Actions	
<i>Have you contacted your insurer?</i>	
• Have you given your insurer your preliminary damage assessment?	<input type="checkbox"/>
• Has your insurer been able to tell you what your insurance payout is likely to be, when will it be made and whether it will be in the form of cash or asset replacement or a mix of both?	<input type="checkbox"/>
<i>Have you contacted your staff and other key stakeholders?</i>	
• Are you keeping staff and stakeholders, including key customers suppliers and lenders informed of what you are doing?	<input type="checkbox"/>
• Do you need to disengage staff for the time being?	<input type="checkbox"/>
• Do you need to postpone purchasing supplies for the time being?	<input type="checkbox"/>
• Can you cancel orders that you have made?	<input type="checkbox"/>
• If customers have ordered stock and it is lost or you can not supply at this time, have you informed those customers?	<input type="checkbox"/>

Financial position of the business	
<i>What is the current financial position of your business?</i>	
• Have you reconstructed the financial records of your business?	<input type="checkbox"/>
• If you can not fully reconstruct your accounts, do you have access to historical financial statements or industry benchmarks?	<input type="checkbox"/>
• Have you determined how much cash your business has currently available by creating a cash flow statement?	<input type="checkbox"/>
• Have you created a balance sheet and a profit and loss statement from the beginning of the current financial year to the time of the disaster?	<input type="checkbox"/>
• Have you used the information in the cash flow statement, profit and loss statement and balance sheet to analyse the financial health of your business at the current point in time?	<input type="checkbox"/>

Recovery Plan	
<i>Questions to consider in creating a recovery plan include:</i>	
• Have you considered and noted your recovery objectives, actions and priorities?	<input type="checkbox"/>
• Have you established a recovery team with clear responsibilities from the recovery plan?	<input type="checkbox"/>
• Can you support such team members working off-site?	<input type="checkbox"/>
• Are you aware of all the requirements to reopen the doors for business? For example: <ul style="list-style-type: none"> • Do you need to arrange for the short-term lease of essential equipment until they can be replaced? 	<input type="checkbox"/>
• Do you have adequate resources (staff, finances, etc) to bring the business up to normal operating levels or to a level you want or to the level that reflects the current market conditions?	<input type="checkbox"/>
• Have you costed your recovery plan?	<input type="checkbox"/>
• Can you afford such a plan?	<input type="checkbox"/>
• Do you have a marketing strategy to promote that you are open for business?	<input type="checkbox"/>
• Have you incorporated your lessons from running your business prior to the disaster (good and bad) in your recovery plan?	<input type="checkbox"/>
• Have you incorporated your analysis of the market conditions post the disaster in your recovery plan?	<input type="checkbox"/>
• Does the recovery plan reflect your financial goals (for example the profit, net profit margin or return on investment you want to achieve)?	<input type="checkbox"/>
<i>Have you considered the following your recovery plan:</i>	
• Addition of new product lines or removal of existing product lines?	<input type="checkbox"/>
• Addition of new services or a reduction of services?	<input type="checkbox"/>
• Reducing operating costs?	<input type="checkbox"/>
• Adoption of new technologies and processes?	<input type="checkbox"/>
• Relocation?	<input type="checkbox"/>

Funding the reopening of your business	
<i>Can you afford to reopen your business?</i>	
• Have you completed cash flow and profit and loss forecasts?	<input type="checkbox"/>
• Have you used these forecasts to run 'what if' scenarios to measure how your cash flows will be impacted by unexpected events?	<input type="checkbox"/>
• Do you intend to fund the reopening of your business from existing sources from the business, your own resources, other investors and banks and other lenders or a mix?	<input type="checkbox"/>
• Do the forecasts and your financial statements show whether the business can afford to use internal or external sources of finance to fund the reopening?	<input type="checkbox"/>
• If not, can you adjust your recovery plan so that it is affordable?	<input type="checkbox"/>
• If you can not afford your recovery plan, have you considered exiting your business?	<input type="checkbox"/>
• Where the business has existing debt financing arrangements, have these been reviewed to ensure that the finance facility and structure fits the new needs of the business?	<input type="checkbox"/>
<i>Sources of finance</i>	
• Even if you can fund the reopening of the business from existing sources, have you analysed whether it is better to use external sources of finance?	<input type="checkbox"/>
• If you are seeking debt finance, have you spoken to your bank about your recovery plan and your funding needs?	<input type="checkbox"/>
• What existing lines of credit does the business have access too and can these lines of credit be accessed to fund the reopening of business?	<input type="checkbox"/>
• If you do seek debt finance, what security does the business now have available?	<input type="checkbox"/>
• If you are seeking debt finance, have you determine for what reason you are seeking the money for (e.g. to fund stock purchases or the buy equipment), over what term you are borrowing for and how much?	<input type="checkbox"/>
• Have you considered financing the reopening of your business from your own resources or from other investors?	<input type="checkbox"/>

Physical requirements	
<i>Location</i>	
• Given the potential changed market conditions, is your business premises situated in the right location?	<input type="checkbox"/>
• Are there any plans by local government or others that may impact the viability of the location of your business, such as changes that may restrict access?	<input type="checkbox"/>
• Have other businesses reopened or are going to reopen in your area?	<input type="checkbox"/>
• Is the size of your premises to large or small given the future potential of your business?	<input type="checkbox"/>
<i>Major Equipment</i>	
• Do you still have the plant and equipment your business needs to restart?	<input type="checkbox"/>
• If not, will you receive such equipment from your insurer or will you have to purchase this equipment?	<input type="checkbox"/>
• If you have to purchase the equipment, have you analysed whether it is better to pay for, lease or hire purchase the equipment?	<input type="checkbox"/>
• Is the purchase of the equipment (including maintenance costs and insurance) justified given the possible changed market conditions?	<input type="checkbox"/>
• Is the necessary expertise readily available to install the equipment?	<input type="checkbox"/>

Physical requirements (continued)	
<i>Inventory</i>	
• If stock or supplies are to be replaced, have you reviewed historical information to see which stock is slow-moving?	<input type="checkbox"/>
• For stock identified as slow moving, have you considered removing from your range?	<input type="checkbox"/>
• Have you made an assessment of whether the changed market conditions will impact upon the buying patterns of your customers?	<input type="checkbox"/>

Marketing	
• Do you intend to advertise that your business has re-opened?	<input type="checkbox"/>
• Is there any promotion of your local area by government and others?	<input type="checkbox"/>

Pricing	
• Have you undertaken a break/even analysis to determine whether the prices you charge are making the profit you want to achieve?	<input type="checkbox"/>
• Have you compared your pricing to your competitors?	<input type="checkbox"/>

Staffing	
• Are your existing staff still willing and able to work for you?	<input type="checkbox"/>
• Can the staff assist with the re-opening of the business?	<input type="checkbox"/>
• Has the potential changed market conditions (possible falling demand) impacted on your ability to retain your existing staff and on the hours they previously worked?	<input type="checkbox"/>

Lessons learned	
• Have you documented lessons learnt from your business recovery?	<input type="checkbox"/>
• Have you considered putting in place a business continuity plan to help you in case you go through another disaster?	<input type="checkbox"/>
• Have your reviewed your insurance policies to see whether they are adequate and whether there are any gaps in your insurance coverage?	<input type="checkbox"/>

Other	
<i>Business licenses, etc</i>	
• If you lost copies of your business registration certificates, licenses and other official documents necessary to operate your business, have you approached the relevant agency to get them replaced?	<input type="checkbox"/>
<i>Record keeping</i>	
• Have you considered what accounting system are you going to use or continue to use to keep the financial records up to date?	<input type="checkbox"/>
• Are there any improvements you can make to your record keeping system, such as keeping backups of your financial system offsite?	<input type="checkbox"/>
<i>Meeting statutory obligations</i>	
• What statutory obligations you have to meet, such as lodging a tax return?	<input type="checkbox"/>
• Has the requirements to lodge and pay such returns/forms/obligations been delayed?	<input type="checkbox"/>
• Has your reconstructed financial records given you the necessary information and evidence to be able to complete such returns?	<input type="checkbox"/>
<i>Thanking everyone</i>	
• Have you thanked everyone involved in assisting you?	<input type="checkbox"/>

Reconstructing financial records after a disaster

Checklist of potential sources of information to assist with reconstructing financial records after a disaster

One of the first business steps you should take after a disaster is to attempt to reconstruct your financial accounts. Such reconstructed financial records will give you much of the information you need to make decisions on the future of your business.

If you have not been able to salvage your financial records, your first step to reconstructing your financial records is to seek evidence of past financial transactions. Such evidence will provide the base upon which you or your accountant can begin reconstructing your financial records. The main source of such evidence will be from the business's own records. Where such records no longer exist or are incomplete, examples of other sources of such evidence include:

Checklist of potential sources of information

Source	Potential information
Australian Taxation Office, state revenue authorities	Prior income tax returns, Business Activity Statements, Fringe Benefit Tax returns, PAYG Annual Statements, Employer Declarations, Payroll Tax returns, etc.
Accountant and financial adviser	Your accountant and financial adviser may have copies of financial statements and tax returns for your business.
Banks, credit unions and building societies	Past bank statements provide a great resource. For example, businesses may remember or take a good guess at many of the transactions on a bank statement, even though the primary record of the transactions are gone. Banks can charge for replacement statements, however they may waive such fees.
Surviving files	See if any files, including electronic files can be recovered from the disaster. For electronic files, even though the hard drive may look bad, experts may be able to recover the data. Whether this is undertaken is dependant on how valuable the data is and whether the data can be sourced elsewhere.
Off site sources	Are any files kept off site, for example, where activities are outsourced e.g. IT, payroll, etc. In such a situation, the service provider may have information still on file.
Staff	Ask staff whether they have records off site, for example, emails and other documents in their computer, memory sticks and other electronic storage devices etc.
Lender	Where a business has borrowed money from a bank or other lending institution, speak to that institution. Banks may undertake an annual review of the business. At such annual reviews, the business will be asked to provide financial information to their bank, thus the bank should have on file your financial statements and forecasts.
Customers and suppliers	Customers and suppliers may have invoices, remittance advices, purchase orders, receipts etc that they may share.
The Australian Securities and Investments Commission	If the accounts are audited, the audited accounts may have been lodged with ASIC.
Auditors	If the accounts are audited, the auditors may be able to provide copies of work papers and other records obtained during the audit.
Insurer	Speak to your insurer, as your insurer may have a list of the assets owned by the business (if provided by the business).
Other government agencies	If the business has received government funding/grants, the awarding government agency may have records.
Accreditation or certification bodies	If the business is subject to any other form of audit, certification or accreditation of their activities those bodies may have records that could be used.
Titles Office	The Titles Office should have copies of titles to properties
Lawyers and finance companies	They may have copies of contracts that the business has entered in to (including hire purchase agreements).
Email correspondence	The business, the business's ISP or staff may have copies emails and documents forwarded to clients, suppliers and other relevant parties. This will also have the additional benefit of assisting with the reconstruction of contact list if not backed up. If a blackberry / PDA was in use, significant data may be available from the carrier if hand set lost.
Share registries	Where the business owns publicly traded securities.

Where it is not possible to fully reconstruct financial records, the information you have been able to find plus your knowledge of the business should give you a fairly comprehensive approximation of the financial position of your business. If that is not successful, a potential solution may be to apply industry benchmarks to the information you have been able to reconstruct. Such benchmarks may be available from the ATO, the Australian Bureau of Statistics and private providers such as Business Benchmarks by FMRC (available to members at the CPA Australia library), IBISWorld, etc.

As well as reconstruction of records, and if not already considered, it may be worth putting in place temporary measures for the recovery phase such as recording of current activities and transactions, managing cash flows and working with key clients, suppliers and government.

Following the reconstruction of financial records, businesses will be in a position to evaluate their financial position and from there, consider how to re-establish their business and what may be their financing requirements.

Analysing the financial health of a business after a disaster

Introduction

As part of the planning process you should undertake before you reopen your business after a disaster, it is recommended that you analyse the financial health of your business. Such analysis will assist you determine whether it is financially viable for you to reopen your business, to find areas where the business can be improved and where your business was doing well before the disaster.

Financial ratio analysis is a common method used to analyse the financial health of a business and in normal circumstances, predicting the potential for success or failure, and progress of a business. However, due to the changed circumstances after a disaster, such analysis may not be effective in predicting future trends.

Such analysis will also enable you to spot any trends that were emerging in your business prior to the disaster and to compare how your business performed against similar businesses in the same industry. Such information will be useful in determining how you want your business to operate after you reopen it.

Financial ratios

There are many financial ratios a business can use to assess its financial health. The main ratios (which are grouped into broad areas) are:

Liquidity ratios

Liquidity ratios assess your business's ability to meet its obligations as they fall due. In general it is better to have higher ratios in this category as an indication of sound business activities and an ability to withstand tight cash flow periods (which is likely after a disaster):

$$\text{Current Ratio} = \frac{\text{Total Current Assets}}{\text{Total Current Liabilities}}$$

The Current Ratio measures whether the business has enough current assets (cash at bank, debtors, inventory and other assets that can be turned into cash quickly) to meet its debts (debts that are due in the next 12 months). A generally acceptable current ratio is 2 to 1, however this will depend on the nature of the business.

$$\text{Quick Ratio} = \frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities} - \text{Overdraft}}$$

The Quick Ratio helps answer a fundamental question for businesses affected by a disaster – ‘If the business does not have any sales income, could my business meet its current obligations (without having to sell inventory at knock down prices)?’

Solvency ratios

These ratios indicate the extent to which the business is able to meet all debt obligations from sources other than cash flow. Commonly used solvency ratios are:

$$\text{Leverage Ratio} = \frac{\text{Total Liabilities}}{\text{Equity}}$$

The Leverage (or Gearing) Ratio indicates the extent to which the business is reliant on debt financing versus owner’s equity (the owner’s financial contribution to the business). Generally speaking, the higher the ratio, the more difficult it will be to obtain further debt.

$$\text{Debt to Assets} = \frac{\text{Total Liabilities}}{\text{Total Assets}}$$

This ratio measures the percentage of assets being financed by liabilities. Generally speaking, this ratio should be less than 1, indicating that there are enough total assets to meet all debt obligations.

Profitability ratios

These ratios measure your business performance and ultimately indicate the level of success of your operations. You can use these ratios to assist you determine whether the pricing of your products and services before the disaster were adequate to achieve a profit, meets the profit you wanted to achieve and how it matches with industry averages. These ratios can guide you in your pricing policy upon reopening.

$$\text{Gross Margin Ratio} = \frac{\text{Gross Profit}}{\text{Net Sales}}$$

The Gross Margin Ratio measures the percentage of sales dollars available to pay the overhead expenses of the business, after purchasing or manufacturing the inventory sold.

$$\text{Net Margin Ratio} = \frac{\text{Net Profit}}{\text{Net Sales}}$$

The Net Margin Ratio measures the percentage of sales dollars left after all expenses (including stock), except income taxes. This ratio will provide an opportunity to compare your business’s ‘return on sales’ with the performance of other businesses in your industry.

Management ratios

If you are assessing your financial health before the disaster, management ratios monitor how effectively you were managing your working capital. For example, if the days you were taking to collect your debtors is longer than the days you were taking to pay your creditors, then there was a cash flow issue as you were paying money out before you were receiving money for that same good or service. This indicates that upon reopening your business, you should seek longer terms of trade from creditors and try to reduce the length of time it takes to collect debts.

$$\text{Days Debtors} = \frac{\text{Debtors}}{\text{Net Sales}} \times 365$$

$$\text{Days Creditors} = \frac{\text{Creditors}}{\text{Inventory}} \times 365$$

Balance sheet ratios

These ratios indicate how efficiently your business is using assets and equity to make a profit.

$$\text{Return on Assets} = \frac{\text{Net Profit Before Tax}}{\text{Total Assets}} \times 100$$

This ratio measures how efficiently profits are being generated from the assets employed in the business. This ratio will only have meaning when compared to similar businesses. A low ratio in comparison with industry averages indicates an inefficient use of business assets and something to be watched upon reopening of your business.

$$\text{Return on Investment} = \frac{\text{Net Profit Before Tax}}{\text{Net Worth}} \times 100$$

The ROI is perhaps the most important ratio of all as it tells the owner whether or not all the effort put into the business has been worthwhile. If the ROI is less than the rate of return on an alternative, low risk investment such as a bank savings account, the owner may consider that option rather than funding the reopening of the business.

Comparing performance to other businesses

To compare the ratios of your business prior to the disaster to other similar businesses in your industry, you need to access your industry's benchmarks. Such benchmarks may be available from your accountant, industry association or a government body responsible for small business.

Recovery plan template



Critical Business Activities	Preventative/Recovery Actions	Resource Requirements/ Outcomes	Recovery Time Objective	Responsibility	Completed
Production Services – halted	<ul style="list-style-type: none"> • re-assess financial position of business including cash flows due to loss of revenue to meet minimal overheads • minimise overheads – review expenses and develop plan of action to reduce fixed and variable overheads include reduction of casual and permanent staff hours • negotiate with suppliers to prevent build-up of materials and reduce costs • source alternative production site • diversify product range and services offered e.g. repairs and restoration 	<ul style="list-style-type: none"> • put aside cash reserves to cover costs • reduce costs where able • research new products and services • identify alternative production site 	2 weeks	Business owner/ operator	0/0/0

Source: 'Business Continuity Plan Template' Department of Tourism, Regional Development and Industry, Queensland Government 2008, p. 20.

Checklist for Managing in Times of Financial Difficulty

FACT SHEET June 2009

Introduction

This checklist is designed to give guidance to businesses on how they can manage through difficult times. Difficulties can be caused by external factors such as a fall in consumer sentiment, rising fuel prices, customers moving to competitors, difficulty accessing finance or increasing interest rates; or they could be caused by internal factors such as poor risk management, failure to manage cash flow properly or because of a margin squeeze.

Regardless of the causes, small businesses need to take action when the going gets tough. While there is no single cure-all, there are many steps a business owner can take to manage through the difficult times and position the business for future growth.

This checklist provides some tips and suggestions.

Taking stock of your business

Adopting a risk management mindset is the key. The first step is to take stock. Business owners need to identify and manage any weaknesses in their business or their industry's performance, while not being blinded to any new opportunities that might emerge.

To take stock of your business, you should:

Understand your customers

Any business begins and ends with the requirements and behaviours of the customer. If your customers aren't satisfied, the rest does not matter. It is therefore fundamental to understand your customers, including their paying habits. You need to understand why your customers buy your product or service. Is it a luxury or is it a discretionary product? Do you deal in mature products or staple items? Are your customers fickle and price sensitive or are they long-standing and faithful?

Measure, measure, measure

There are a number of key indicators which will quickly tell you how your business is tracking. They could be as simple as the value of daily sales, or the cash balance or the debtors' balance, or the value of orders and invoices you owe to suppliers. Or they could be an activity indicator such as total billable hours, an occupancy or usage factor, the value of bookings for next week or an average sale value. Create a graph showing these indicators and update it daily or at least weekly. It will quickly show you any adverse trends as they emerge.

Take action with a purpose and for the right reasons

Develop strategies that aim to boost your cash position and/or profitability (you can be making a profit but still go out of business because you lack sufficient cash), without starving the business of the essential investment in stock or promotion. Keep looking for underlying improvements in the business; don't just cut costs. In this way, your corrective actions will also put your firm on a better footing for longer-term success.

Change your attitude

Don't just do what you've always done. Remember that what you did last week may well have contributed to the unsatisfactory situation you find yourself in today. Consider new angles on old problems. Work on the parts of the business you can influence. Learn from others in the industry and be prepared to be flexible. Prepare financial statements and benchmark the information that emerges from them against industry averages. Get someone else to have a look at your business, particularly your CPA.

Review your current position. Identify your problem areas and your strengths before trying to trade your way out of difficulty.

Checklist for Managing in Times of Financial Difficulty

Tips for improving the financial position of your business

The importance of financial management cannot be overemphasised, especially when business conditions become difficult.

Ideas to improve the cash position of your business

While profits may be the measure of success, it is cash that determines business survival. It is very important for the viability of your business to convert your customers' outstanding debt into cash.

- **prepare regular cash flow forecasts.** If your business is having cash flow difficulties, you should be preparing such forecasts on a regular basis. They will show the likely extent of any crisis, and how long it might last.
- **keep an eye on your entire cash cycle.** If you are in a difficult cash position, skew promotions towards those services or products which consume less resources or which can be turned into cash more quickly. In other words, generate cash through sales but don't undersell your products or services. You must make a profit.
- **measure and reward the right behaviour in your staff.** For example, sales commission should only be paid on receipt of payment, not when a credit sale is made. This will encourage sales staff to focus on making sales to customers who are most likely to pay.
- **make full use of your terms of trade as this amounts to an interest-free loan.** Don't pay your suppliers too early or outside their agreed trading terms. Be seen as a solid, dependable customer. Having a good reputation will give you better scope for negotiating deals and favourable trading terms.
- **don't let personal drawings get out of hand.** Ideally, the owners should take a modest but regular wage or drawing, and leave the remaining cash in the business. Keep any fringe benefits or withdrawals of stock to a minimum.
- **don't hide your problems from your bank.** Keep the lines of communication open. Demonstrate that you are on top of your business and understand your cash flow. Show you can provide financial information if you need to ask for temporary relief on loans.

Ideas to improve the profitability of your business

A profitable business is generally a successful business and your margin is a measure of that success.

- **prepare financial statements on a regular basis.** These will give you the information you need to determine your overall profit margin and where costs can be saved. They can also be used to determine the margin on individual items of stock and to compare how your business is performing against industry averages.
- **focus on boosting profit.** Retained profit is an important source of cash to meet your obligations and it can also be used for investment. To maximise profit, you need to focus on sales that give you the highest margin, not just 'sales'. The only exception to this rule is when you deliberately set out to achieve another aim such as disposing of dead stock to make way for profitable stock.
- **if possible, don't discount prices on lower margin products or services.** Use an alternative strategy, such as bundling in support services for a higher price. This is an especially valuable strategy with slow moving lines as it justifies the investment in them.
- **understand the profit contributions of each of your products, and your main customers.** This will show you where to best focus your efforts and identify opportunities for improvement.
- **don't discount unless you can achieve the same or better gross profit margin.** It may require large increases in sales to generate the same amount in gross profit. While some price discounting may be required to get shoppers' attention, a much better approach is to deliver the discount through, for example, an add-on product. This should deliver more dollars of gross profit to the business. See the effect of discounting on gross profit below.

Checklist for Managing in Times of Financial Difficulty

The effect of discounting

Present gross profit margin	10%	15%	20%	25%	30%	35%	40%
If you cut your price by:	... to achieve the same gross profit margin, you will need to increase your sales by:						
5%	100.0%	50.0%	33.3%	25.0%	20.0%	16.7%	14.3%
6%	150.0%	66.7%	42.9%	31.6%	25.0%	20.7%	17.6%
8%	400.0%	114.3%	66.7%	47.1%	36.0%	29.6%	25.0%
10%		200.0%	100.0%	66.7%	50.0%	40.0%	33.3%
12%		400.0%	150.0%	92.3%	66.0%	52.2%	42.9%
15%			300.0%	150.0%	100.0%	75.0%	60.0%
20%				400.0%	200.0%	133.3%	100.0%

Other ways of improving the cash position and profitability of your business

Controlling costs

Costs need to be controlled to a level consistent with the firm's needs. Don't just cut costs. Longer-term and recurring savings are better than short-term wins. Once the easy savings are made, focus on improving sales and gross profit, as that will have a larger impact on the future success of your firm.

- **identify the expenses that keep you in business.** For example, presentation of premises, advertising and promotion, enhancing staff skills. Keep them at sustainable levels. Remember the old saying, 'penny wise, pound foolish'.
- **look at costs carefully, but don't criticise every individual transaction or usage.** Often a review of the business's processes can eliminate the need for certain costs completely. For example, total interest costs might be reduced by changing debt products, by negotiating a lower margin with your bank or another bank or by reducing the amount of debt being used .
- **measure the success of each promotional activity or campaign.** For example, direct response type advertising (direct mail or emails or coupon ads) is considered more cost effective than advertisements in papers or magazines, as well as being more measurable. This does not necessarily mean cutting your promotional spending: it just means increasing its efficiency.
- **be flexible in your staffing arrangements.** Review staff availability against customer flows. For example, a core of full time, permanent staff supplemented by a group of casual or part-time workers may help you through busy periods. However, make sure you are familiar with appropriate legal requirements.
- **don't forget that your staff are a key resource, especially in today's tight employment markets.** Replacing staff can be very costly. Correct motivation and incentives are key to creating an environment where people want to stay and succeed.

Reduce your customer debt

Keep in regular contact with customers about unpaid invoices. You would be surprised how many businesses don't chase up late payment.

- **keep in touch with your customers** by asking questions such as:
 - were you happy with the product/service?
 - did we provide you with the right paperwork?
 - when might we expect to be paid?
- This is particularly important if you are discounting sales, as you have less gross profit margin to generate the cash you need to run your business.
- **negotiate periodic payments if that helps your customer clear overdue amounts.** But make sure they stick to their side of the deal. For example, you might accept 90 per cent of the old balance if it's paid by a certain time.
- **perform credit checks and establish and agree on proper commercial terms for future dealings with customers, including realistic credit limits.** Some customers may not be worth the effort if they continue to pay late and cause extra administration costs.
- **make sure your invoicing and debtors listing is well managed.** Don't let poor or sloppy processes, such as not preparing aged debtor reports, contribute to customers delaying payment.
- **encourage your customers to pay immediately** with discounts for cash sales, for example.

Checklist for Managing in Times of Financial Difficulty

Control stock

The essential principle is to have the right level of stock to satisfy the needs of your customers and to have room for new items.

- **keeping stock levels low reduces the amount of money you have tied up in stock**, thereby freeing cash for other uses. It also helps to keep your storage and display costs down and reduces your risk of carrying 'unsaleable' stock.
- **get rid of slow-moving and obsolete stock**. Either put it all in a clearance bin so you can convert it into cash or write it off and destroy it to clear storage space. Carrying too much stock or dead stock means you are tying up cash. Removing it will help you focus on the stock that generates the cash and the margins that keep you in business.
- **maintain necessary stock** in order to maintain sales momentum and ensure customers are never disappointed over the basic products in your range.
- **tighten the buying of stock**. Knowing the volume sales per stock item will help you buy the right amount. Carrying not enough stock may discourage customers as you may not be immediately able to satisfy their needs and carrying too much means you are tying up cash that could be put to better use.
- **negotiate deals with suppliers but avoid volume-based discounts**. When money is tight, there is no point investing in next month's stock without good reason. Instead of volume discounts, try to negotiate discounts for prompt settlement (unless your cash position is poor) or negotiate for smaller and more frequent deliveries from your suppliers to smooth out your cash flow.
- **don't let discount prices drive your stock-buying decisions**. Buy stock you can sell at a profit in a reasonable time frame.

Improve sales

Focus on the additional profit from sales. Don't think that more discounted sales are the true measure of success.

- **don't chase just any sale; chase profitable sales**. The only exception to this rule should be when you deliberately set out to achieve another aim such as getting rid of dead stock or building market share.
- **create added value with your offers**. For example, provide a gift or bonus with certain purchases or a discount on a second item. Or else, include a free training session with the purchase of a capital asset such as a photocopier. This tactic is especially effective if you can bundle a slow moving or dead stock item at a discount together with a fully priced fast moving item. You are delivering customer value while making a sale of an item you might not have otherwise sold.
- **encourage companion selling and up-selling by your sales personnel**.
- **use in-store signs to highlight the product of the week, or today's special**. This is a very low cost way of generating traffic and interest in a retail environment. It might get customers into the habit of coming back tomorrow for the special of the day.

The best run businesses use these ideas during the good times as well as the bad in order to maximise their profits and minimise risk. Using them can help your business to emerge in a much improved market condition which will very likely lead to long-term growth.

Checklist for Managing in Times of Financial Difficulty

The Checklist

To improve the cash position of your business

- prepare regular cash flow forecasts
- generate cash through sales but do not undersell your products or services
- only pay sales commission once payment is received
- negotiate extended terms of trade with suppliers
- take modest personal drawings or wages
- don't hide any problems from your bank. Tell your bank early if you need money to overcome a cash flow problem

To improve the profitability of your business

- prepare financial statements on a regular basis and use them to analyse performance and benchmark your business against industry averages
- understand the profit you generate on each item of stock or service you provide
- concentrate on improving sales of your most profitable stocks or services
- don't discount prices on lower margin products and services
- don't discount on your most profitable products or services unless the discount encourages increased sales that lead to at least the same profit

To control costs

- identify the expenditures that are essential to keep your business running. Don't cut these costs
- look at costs carefully, but don't criticise every transaction
- conduct a review of the business's processes to see whether some expenses can be eliminated completely
- direct marketing expenditure towards direct response advertising (e.g. direct mails, emails and coupons)
- review staffing arrangements
- work to retain good staff. Remember that replacing staff can be expensive

To reduce your customers' debt

- keep in regular contact with customers, particularly customers who have outstanding debts
- prepare an aged debtors report
- negotiate periodic payment if that helps customers to clear overdue amounts
- before you sell to a customer on credit, perform a credit check and agree on proper commercial terms of trade
- encourage your customers to pay immediately by offering discounts on cash sale, for example

To control stock

- keep the right amount of stock – too much and not enough stock can damage a business
- identify slow moving and dead stock and try to sell it. If you can't sell it, write it off and destroy it
- identify items you simply must never run out of
- negotiate deals with suppliers but avoid volume-based discounts
- tighten the buying of stock by knowing when to buy. To do this you will need to know the volume sales per item. Don't let discounts drive your buying decisions

To improve sales

- focus on the most profitable sales. Don't chase just any sales
- create added value with your offers by providing a gift or training, for example
- undertake companion selling and up-selling
- use in-store signs to highlight the product of the week

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CPA126511_06/2009

Exiting your business

Most businesses affected by a disaster will reopen their business in some form. However some businesses affected by a disaster will not reopen. Estimates from the US indicate that in the US, up to 40 percent of businesses never reopen following a disaster and of the remaining businesses, 25 percent will close within two years.

Reasons for considering winding up a business

The reasons why a business may be wound up are many – a natural disaster may just bring some of those reasons to the fore. Some of those reasons could include (and many of these reasons are linked):

- Having insufficient funds to recommence operations, or if you do recommence, having insufficient funds to continue operating
- Your business carries too much debt and you are unable to service that debt
- Inadequate cash flow
- Insufficient range of products or services or the wrong range of product and services
- Insufficient sales/poor location
- Lack of planning for the reopening of the business and an inability to adapt to the new environment
- Poor credit controls and inadequate debt collection
- Ill health of the owners and key employees.

Consequences of continuing a business while insolvent

There are risks if you continue a business while it is insolvent. For information on the consequences of insolvent trading, please visit the Australian Securities and Investments Commission [web site](#) or your accountant or lawyer can explain to you those risks.

How to exit from your business

There are several ways in which the business owner can exit from their business, including:

- Selling the business
- Passing the business on to a family member, partner, employee or other stakeholder
- Merging the business with another business
- Closing down the business – sell of the assets and stop trading
- Liquidating – liquidate the business and sell off the assets
- Forced closure – file for bankruptcy or liquidation.

Further guidance on exiting from your business

If you are considering exiting from your business, further guidance can be found in the CPA Australia publication **[Guide to Exiting Your Business](#)**.

Guide to Exiting Your Business

INTRODUCTION

Sooner or later most business owners come to a time when they will start to think about moving on and exiting from their business. Regardless of your reasons and the strategy you chose, you will undoubtedly improve your outcome if you seek professional advice along the way.

There are many reasons behind the decision to leave a business. Some of the more common reasons given by business owners are:

- It's time to retire.
- Someone has made an offer for the business that is hard to refuse.
- They want to make a change in direction or involvement.
- The business has been very successful and the owner wants to cash in on its goodwill and success.
- It's time to pass the business on to family members.
- They have new plans and want to sell the business and use the cash for other purposes.
- There have been changes in family circumstances, such as illness.
- There are changes in the business owner's circumstances, such as illness or old age.
- The owner is moving out of the area.
- There have been changes in the marriage situation such as divorce.
- The owner is faced with increased competition and decide that operating the business is becoming harder and harder.
- After the loss of a key staff member, the owner decides it's becoming more and more difficult finding good staff and managers.
- The owner is simply tired and it is time to have a short break before he gets too old to enjoy life.
- The business is failing and it is time to get out.
- The business has failed and bankruptcy and liquidation is the only alternative.

Ways of exiting

The several ways in which the owner of the business can exit from his or her business includes the following:

- Selling the business – Sell the business as a going concern.
- Passing the business on – Pass on the business to family members or other stakeholders.
- Merging – Merge the business with others.
- Closing down – Close up the business, sell off assets and stop trading.
- Liquidating – Liquidate the business and sell off assets.
- Forced closure – File for bankruptcy (if not a corporation) or liquidation (if a corporation).

SELLING THE BUSINESS

The important decision

If your business has been any sort of a success, you probably had to pour most of your resources and a lot of time and heartache into your business. A lot of businesses involve family members, so often it is the main subject of conversation around the dinner table or even on holidays. A business is therefore considered a big part of the owner's and owner's family's life. It may be difficult to imagine life without the business.

On the other hand, your attitude may be that the business is a 'pain in the neck' and has been a source of unhappiness for many years and that it is now time to get rid of it.

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Guide to Exiting Your Business

Whatever the business owner's situation, selling the business is still one of the most important things that they will ever do because unlike other decisions that have been made over the years this decision is a final one and there will be only one chance to put the anticipated price tag on it. The owner will want to come out well ahead financially of course, and so will want to negotiate a price in satisfying terms and meet all the reasons for selling out.

The major issues that need to be addressed when it is time to sell your business include the following:

- Valuation of the business – from the owner's point of view, the aim is to maximise the gain that is obtained from the disposal of the business, but is constrained of course by what the market perceives as the value.
- Who will buy? – the owner may need to consult a business broker or other professional to arrange the sale so that it is put before as many potential buyers as possible.
- Selling issues – all the issues involved in the sale, such as the time to sell, what is sold or what assistance to give after the sale will have to be settled.
- How the deal is structured – the terms of the deal such as payment terms and taxation implications will need to be brought into the calculation.
- Financing the sale – a decision has to be made as to whether the owner will leave some financing in the business or whether this will be a clean all cash deal.
- Completing the sale – the full process from the initial letter of intent through to the final closing of the deal should be made very clear to the owner so that there is no room for confusion.

Make the offer known

There are a number of ways to let buyers know your business is for sale. The best channels will depend on the business and the circumstances but the following methods are among those that are commonly used:

- Use of business brokers or real estate agents.
- Newspaper advertising.
- Trade publications and other trade contacts such as suppliers, distributors, manufacturers etc.
- Word of mouth.

Each method has its own advantages depending on what you are looking for but the seller should decide on whether to reveal the pending sale to their customers, employees and suppliers before the sale is completed.

Sometimes prior publicity of the sale can harm the future of the business making it less attractive to a prospective buyer and less profitable to the seller. One of the best ways to arrange a sale is to deal through business brokers or real estate agents who specialise in selling businesses because they can handle the complete transaction confidentially and professionally.

The agent should have wide contacts locally and be skilled in assessing potential buyers and screening them to find those who are legitimate and those who are just wasting time. They should also be thoroughly familiar with the business itself and must do everything possible to bring the buyer and seller together to finalise a mutual agreement.

Handling buyers and closing the sale

The seller's ability to present the business in the right way and handle the transaction properly will enhance the chances of obtaining a good price and protection.

The seller should do the following:

- Consult a competent accountant and lawyer and discuss their requirements.
- Define the strong points of their business so that these can be emphasised in negotiations.
- Make sure that business records are tidy and complete and available for inspection when necessary.
- Ensure that time is not wasted on non-serious buyers and those without sufficient capital or the background and experience to carry on the business.
- Check the track record and reputation of the serious prospects because if the next owner fails to make a success of the business it could mean final balance owing to the seller may be lost
- Check the proposed financing arrangements and ensure these are clearly outlined in the agreement.
- Make sure that other matters such as the transfer of the lease and transfer of hire purchase agreements on assets etc have been cleared. If not cleared, an adjustment should be made in the calculation of the purchase price
- Close the whole deal through a competent solicitor and obtain professional tax advice as to the tax implications by correctly structuring the arrangements.

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Guide to Exiting Your Business

Main points when selling

There are really three questions that must be clearly spelled out when you are looking at selling an established business. These are:

- Why your business is for sale
- How much is it worth
- How is the sale to be finalised

Reasons for selling

The important question when looking at selling an established business is being clear on your reason for selling. There are many valid reasons that bring a business on to the market.

Some of these are – Genuine (to the buyer):

- Retirement of the owner because of age or ill health.
- Another opportunity that has come up in a different field and therefore the present business needs to be sold.
- Advancement of new technology may also bring an owner to the conclusion that he is unable to cope with the latest changes and thus prompts him to find something else simpler and not requiring as much energy.

Suspect (to the buyer):

Remember that, a buyer would be naive if he does not also look at other reasons, which may in fact be the real cause for an owner selling.

- Declining business,
- Changes in the character of the neighbourhood with reduced need for the business goods or services
- Influx of new competition affecting turnover
- Highway construction coming through the area thus changing exposure and accessibility of customers,
- Expiry of a lease or franchise
- The facilities becoming obsolete and thus not being able to be efficient enough to complete
- The bad reputation of the owner which may have caused a drop in sales
- The rent is up for review and will be due for a high rise
- A new shopping centre is being planned a short distance away and this will affect the future of the business.

There are many reasons that a seller could offer and the cautious buyer would assess fully the situation before committing to buy. This assessment may involve canvassing the area to find out from other traders what is happening and having discussions with the local council and real estate agents as to proposed changes, which may affect the operation.

The reasons for selling therefore need to be in order so if you are selling up, be aware of this.

What is your business worth?

Over a period of time an industry usually develops its own rules of thumb by which a business is to be valued. For example supermarkets may sometimes be valued at say, 5 weeks turnover so that if a supermarket had \$20,000 sales per week then the value would be about \$100,000. These are just rules of thumb or formulas that can be used to arrive at the approximate value of a business.

The sale of a business involves a long-term investment of both time and money by the buyer with no immediate guarantee of return. Therefore one of the most important things that must be considered when calculating the value (and thus sale price) of a business is its future earning profitability. This is the main point in assessing the attractiveness of a business and it should be the basis on which the selling price is weighed or measured when considering fairness and acceptability.

To estimate the potential earning power of the business the buyer will try to find out about past profits, past sales and operating ratios. To evaluate all this information properly the buyer may need an experienced accountant who can investigate and analyse this information. The accountant will need to obtain copies of financial statements and other records of the business for the past three years plus the income tax returns for the business to make sure that the figures being shown have also been the figures that have been supplied to the Tax Office.

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Guide to Exiting Your Business

What will the buyer analyse?

A detailed breakdown of sales and operating costs for the past years can be analysed by the potential buyer to indicate the trends in the business. They will then be compared to other similar businesses in the same trade. The buyer is well aware that there are people that 'cook the books' when they are looking for a sale so approach the sale with honesty. Don't be convinced the buyer will buy if you simply produce an impressive looking balance sheet (such financial records are useless if the business has suddenly collapsed for instance).

The buyer may believe that records have been arranged to suit the seller's purpose. Show business tax returns to prove that tax has been paid on the high profits that are claimed to have been earned. Don't give evasive answers to the buyer's questions. Don't give excuses. The potential buyer will know that refusal to give full explanations and information, or to have figures audited or examined by an independent adviser means it would be better to walk away and cancel the whole deal.

What the buyer will check over

The first thing that a buyer must do in assessing the business that is available for purchase is to review its track record and history and the way it operates. This includes a full investigation of the financial records, as well as its staff, customers, suppliers, competitors and its marketing procedures.

The things that the buyer will look at are:

- Financial records.
- Debtors and creditors
- Staff.
- Customers.
- Premises.
- Location.
- Competitors.
- Lease.
- Patents and trademarks.
- Outstanding legal matters.
- Insurance.
- Marketing methods.
- Licenses and permits.
- Stock (inventory).
- Assets.

Three things you'll want from buyers

A seller is not obliged to complete a deal with a buyer without knowing a little about the buyer's background and the ability to meet commitments. If the seller is financing part of the price, (leaving some finance in), then it is important that the buyer is someone of means and of good reputation and name. The seller will be concerned that the buyer is the right person, otherwise the buyer could destroy the business and any seller finance could be lost.

It is up to the business broker to provide details to the seller about the buyer's situation.

There are three main things that the seller requires from the buyer:

- Background and financial position – the seller must be convinced that the buyer is someone of good standing who will take over the business and look after the clientele and staff in the normal way. If the buyer has been a bankrupt or has a history of business collapses, or perhaps a criminal record, then these matters will be of concern and will affect the seller's decision to proceed or to close off negotiations. The buyer needs to provide evidence to the seller via the broker of financial net worth. This is the case especially where there is a substantial amount of money involved in the transaction.
- The seller wants a good offer – the seller of the business will want as high a price as possible and the buyer naturally will be wanting to outlay as little as possible. During negotiations the parties should really arrive at a fair offer that can be taken as the fair value of the business and which both parties are happy with. This fair offer may differ dramatically from the price originally listed and may be influenced by the appraisal of the business by the broker or by a separate valuation that has been commissioned by the buyer. In any event the deal will have more chance of succeeding if the offer is a fair one.
- A good deposit – the buyer must be able to put down a fair deposit in order to obtain the confidence of the seller. Generally a deposit of up to 10 per cent of the purchase price is expected. If the deposit is too low, then the seller will always feel that, should the buyer breach obligations, the amount at risk is not sufficient for the buyer to comply with the terms of the contract. For a seller to be seriously interested, the buyer must make a commitment by coming up with a reasonable deposit.

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Guide to Exiting Your Business

Due diligence – what it is

Due diligence simply means everyone doing their homework and checking the business out. This is the legal term that professionals use which, boiled down, amounts to using common sense to look at all areas of the business to see if it is the sort of business one wants to buy.

Due diligence will involve a more detailed investigation of every area of business starting from the financials down to production and even such things as who and what time the business is opened and closed.

Due diligence is usually carried out by the potential buyer, as well as the buyer's accountant and other business advisers. There are many businesses that go to the stage of due diligence only to fall over because things are revealed on a closer investigation that were not obvious at the initial discussions and negotiations.

Unfortunately there are many sellers who make false representations, especially in the area of financials. At a proper due diligence meeting the financial figures don't always line up with that which was initially given to the business broker by some business owners. It is a good idea at due diligence for the buyer to have a look at the business plan to see how the actual operation ties up with business planning projections.

It is important to be aware of the buyer's requirements when it is time for due diligence. Everything should be available and tidy as this will generate confidence in your business and hopefully speed up a sale.

How is the sale to be finalised

The seller will want the greatest return for the years of hard work put into the business in the past. The buyer however is interested only in the future and thus both parties can put a different price on the same business while both are being quite reasonable. Negotiation between the two parties is the process by which the gap between the two different prices narrow.

Before carrying out the final negotiations the buyer will be fully aware of the book value of the assets and the maximum amount of money that he or she can pay for the business to obtain a return on the investment required. The investment return needs to equal or better the buyer's salary plus a return on the equity. Negotiations will, as a rule, start at a price lower than has been asked.

Remember that negotiations will not be entirely in money terms. Other details such as the name of the business and job security of the staff etc should also be brought into discussion. Other main points to be finalised include terms of payment, assistance by the seller during transition, and the conditions and terms to be included in the contract for sale and purchase.

Terms of payment

It may be best to put a low value on the assets (stock, plant etc) and make the goodwill figure a high amount because goodwill is not taxable as such. The buyer however, will try and get the reverse (that is high value for assets and stock so that they become a tax-deductible item and a low value for goodwill because this is a non tax deductible item – note Capital Gains tax).

One way of bridging this conflict between the two parties is to have the assets valued highly and then the seller work in or act as a consultant to the new firm after the new owner has taken over. The wages paid will be tax-deductible to the buyer and the seller will have to pay tax on income, but because of this saving to the buyer it may be possible to give the seller a higher wage to make up for the tax paid. Usually in finalising the terms of payment the two parties through their accountants arrive at a fair compromise.

Assistance during transition

The buyer may want to have the seller assist for a short period after the sale so that the new owner can be introduced to important customers and be shown the procedures of how to operate the business in the most profitable manner.

The sale and purchase agreement

As a safeguard against any costly errors, legal advice should always be obtained before any agreement is made up and signed. The agreement should always be drawn up by a lawyer to ensure that all essential points are covered and that both parties know exactly where they stand. Among some of the points that should be included in a typical sale and purchase contract are:

- A description of what is being sold.
- The purchase price.
- The method of payment.
- A statement of how adjustments are to be handled (for example as to stock).
- The buyer assuming responsibility for the business from a certain date.
- Warranties by the seller, if any (for example as to protection for the buyer against any false statements or inaccurate information supplied).
- The covenant of the seller not to compete within a certain time period or within a certain area.
- The time, place and procedure for "closing the deal".

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Guide to Exiting Your Business

Arriving at the price

The matter of a fair price is a question that always provides the biggest problem when the business is to change hands. Methods of valuing a business are covered elsewhere in the material and will not be covered here. Valuation should always be carried out professionally to protect the interest of the seller.

CLOSING DOWN THE BUSINESS

Closing down simply involves closing the doors, selling off all the assets of the business, paying off all the debts and whatever is remaining goes back to the owners. This is not a usual choice unless the business is not doing very well. If the business is a successful one then the owner will obtain far better value from the business by selling it off to a new owner so that they are able to obtain not just the value of the assets less the liabilities, but also value of the goodwill, which is probably the highest value in the whole price of the business.

The scenario for closing will often be:

- Set a date for closing and cut-off of everything.
- If the business has a lease or premises, then arrange it so that closure is at the end of the lease, or come to an arrangement with the landlord.
- Advise all suppliers and associates that the business will be closing on such-and-such a date.
- Advise all customers of the same details, although make sure that they are advised a few days before actual closure so that the business obtains maximum benefit of profitability right up to the time that the doors are actually closed.
- Sell off all the assets of the business and pay off all the bills.
- Arrange for everything to be disconnected, such as telephone, power, etc if applicable.
- File all the necessary returns and financial accounts through your accountant.
- Close the doors, take the balance of the money remaining after paying all the debts and go and have a holiday.

PASSING ON THE BUSINESS

That is – succession

If the business is a family business, which has been in the family for many years, then the current owner may wish to just pass it on to the next members of the family. Generally the family as a whole have a strong desire to see the business kept within the family group and passed from one generation to the next. Succession is a process that requires proper planning and teamwork between the owner and family members.

Whatever changeover is involved, the important thing is to preserve the ongoing viability of the business and to make it appear to the rest of the world as if nothing really has changed. The worst thing that can happen with old owners moving out and new family members taking over, is that customers may perceive it as a changing of the guard and may decide to take their custom elsewhere if they feel that the leadership that they had been so used to and respected has now gone.

Succession of course can also mean the sale of the business to loyal employees or to others like that who have worked with the owner for many years and are entitled to have first choice of taking over the business with the owner gone. However, the greater incidence of succession involves the transfer of ownership to the family so that everything is kept within the family.

Generally a succession plan will have two main factors:

- Transfer of power – the management and control of the business is transferred over to the 'anointed' family member chosen.
- Transfer of assets – the wealth concentrated in the business operation is transferred to family members in the normal way.

When transferring a family business from the older generation to the younger generation, the older generation must get the value they deserve out of the business. This is one of those important questions that have to be "nuttled out" between the parties. One of the best ways of achieving full value for the older generation is simply selling the business off to family members.

In this case a proper professional valuation will need to be put together so that both parties are happy. If selling the business in this way, it is important before the completion of the sale to organise what structure the buyers will run the business under. For example, if the new bosses are the children in the family, then forming a family trust to own and operate the business would be an option that should be considered because of the tax implications and other advantages.

This type of procedure is often used where the owner may want to gift the business to the children, yet still run it through a family trust, to enable proper structuring for the maximum benefit of the new acquisition.

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Guide to Exiting Your Business

Passing it on? – plan now

Many business owners find the fact of the eventual mortality unnerving. They know that sooner or later they need to put together all that is required to pass the business on, but they put that day off to a later time. What they miss is that when a business owner plans for tomorrow, the business increases its strength and therefore its chances of survival. Some statistics from studies done in the USA are interesting – they show the following:

- 95 per cent American businesses are family owned.
- Of these 95% only about 30% survive the second generation.
- Only 10% survive the third generation.
- Just 28% of family owned businesses have developed some sort of succession plan.

These low succession results point to the need to plan succession early. In order to create a smooth succession there are a number of factors that should be considered.

These factors are:

- Family – to avoid any sort of favouritism many owners leave their businesses to their children, all in equal shares. Unfortunately, what happens is those family members often don't see eye to eye and the differences of opinions and arguments can end up hurting the business.
- Qualification – the succession plan should set out that taking over the business by children should not be a right, but should be earned. That is, the successor needs to qualify by having the experience and hopefully working their way up in the business.
- A Board – before the business is handed over, it is advisable to set up a Board of Directors consisting of non-family members. The incoming family owners should then take advice from the Board and because they are not involved in the family the business is strengthened and hopefully a lot of the problems that come through family arguments will be taken care of.
- Take your time – plans for succession cannot be put together in one day. It needs to be well thought out and the replacement managers must be made very clearly aware of their responsibility in continuing the business along the same successful lines as it has been done in the past. The new family managers should understand that full control would be passed over little by little as they prove themselves.
- Don't delay – It goes without saying that the sooner a succession plan is put together the better. It should be one that is flexible enough to be changed as circumstances dictate. For example, parents seem to have already made up their mind that their children will succeed them in the business. However, the children, as they grow may not want to be part of the business as they have their own dreams.

There are obviously many problems that arise when there is a need to put together a plan so that others can take over the operation. The reality is that family members don't always agree and that what the parents have in mind don't always coincide with what the children's desires are.

In any event, planning with whoever is being groomed to take over the business should start early.

MERGING

What is a merger?

A merger theoretically is when two companies agree that they want to go forward as a single operation rather than being two separate entities. Mergers are often driven by the competitive landscape. When times are difficult, strong companies seek out other companies to see if the combination of the two will create a more competitive, cost efficient operation than either one currently is. The stronger of the two companies will gain a greater market share and achieve greater efficiencies perhaps through such a deal. A merger may also be advantageous to the weaker company who is well aware that they are unable to survive independently.

What happens?

Often what happens is that these parties contact one another to see if a merger can be effected and to see if some of the business and staff can be retained.

A merger does not necessarily involve equals. If one company is much larger or smaller than the other a merger can still work. The whole idea of the merger is that the CEOs agree that continuing the business alone is not the best thing for either company, but by merging with each other both should benefit.

Some of the benefits come through from efficiency gains resulting from combining administration and other similar functions. There will also be better cost efficiencies and the combined group will end up with a much higher profile in the industry, which gives more confidence to those with whom their new operation deals.

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Guide to Exiting Your Business

What is an acquisition?

An acquisition of one company by another is a little different from a merger but does not vary by much. All of the above reasons for combining the two companies apply, but instead of swapping stock or consolidating under a new corporate entity, one company simply buys the other company out. Sometimes it is done in a friendly way and at other times it is described as 'hostile'. Another name for the unfriendly acquisition is 'takeover'.

In an acquisition a company can buy another company out with cash or with stock, or with a combination of the two. The difference between the merger purchase and an acquisition purchase depends on whether the purchase is friendly and announced as a merger, or whether it is announced as an acquisition and whether the purchase is unfriendly, in which case it is always called an acquisition.

LIQUIDATING

What is liquidation?

The term liquidation applies only to companies, whereas the term bankruptcy applies to non-companies such as a partnership or sole trader. Generally liquidation occurs when the creditors of the company (those people to whom the company owes money) pass a vote to have the company liquidated. This is usually after a period when the company is under an administration where a separate person called an administrator runs the business to see if something can be salvaged. A liquidator can be appointed by the court following an application by one of the creditors to wind up the company operation. Once the liquidator is appointed, he or she has the duty to all the company's creditors of equal ranking collectively and not just to any particular creditor who filed the application for appointment.

The liquidator's job

The liquidator has certain functions, which are required under law, including to:

- collect and sell all the assets of the business.
- investigate and report to the creditors about any matters to do with the operation of the business, as well as the reasons for the company failing.
- meet all the costs of the liquidation and also setting out who gets paid first.
- distribute all funds to creditors and, if there is any excess, these will go to the owners of the company.
- report to the authorities, as to the conduct of the affairs of the company by its directors and officers, and
- apply for the de-registration of the company when all is finished and the liquidation is completed formerly.

Paying the liquidator

The company pays the liquidator from its assets. If there are insufficient funds or no assets, then the liquidator can remain unpaid unless there is an agreement for the creditors to meet the fees. On some occasions the liquidation cannot proceed because there are no funds to conduct it. In some cases also application can be made to the Court for payment of the liquidator so liquidation can proceed.

The liquidator is paid at a rate, which is usually approved by the creditors.

Rights of creditors

Creditors of a company are paid in order of priority as follows:

- Secured creditors first.
- Unsecured creditors second.
- Shareholders last.

Any secured creditors who hold a security, such as a mortgage over any of the company's assets, are paid first. Unsecured creditors are then paid out if there are sufficient funds. If there are not sufficient funds, then payment is made on a pro rata basis. Finally, if there are funds in surplus then payment is made to return capital to the shareholders. It should be noted, of course, that the costs of the liquidator are met even before the secured creditor is paid out. The liquidator of course will try to obtain as much money as possible from the company, including suing the directors of the company through a creditor if the directors have been negligent and continued trading even when the company was insolvent (that is, unable to pay its debts on time).

Liquidation should only be considered as the last resort. It really only applies when the company cannot pay its debts when they fall due and its shareholders, creditors or the Court finally has to put the company under the control of an independent person whose job it is to close the business, sell off the assets, pay off the remaining debts and return whatever is left to the shareholders. Often there are insufficient funds to meet all debtors.

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Liquidator's rights and duties

The regulatory body sets out clearly what happens in a liquidation and the rights and duties of the liquidator who is the controller of the company.

- The most common form of liquidation occurs when creditors vote for liquidation of the company following a period when it is under administration or, where after a period, the company has failed to meet a court recognised demand for payment. The Court, usually following a creditor's application to wind up a company, may also appoint a liquidator. The liquidator has a duty to all the company's creditors, not just the ones who appoint him/ her to administer and arrange the payment of all liabilities.
- Creditors may agree to indemnify or reimburse a liquidator for costs and expenses if they believe the liquidator can recover further assets for their benefit by undertaking other enquiries. On such occasions after recovering the additional assets the liquidator or creditors can apply to the Court for an order to compensate the indemnifying creditors for the additional risk in funding the recovery by the liquidator. If there is insufficient or no assets the liquidator remains unpaid unless the creditors agree to reimburse them.
- The liquidator is remunerated at a rate or a fixed amount approved by the creditors, the Committee of Inspection comprised of creditors or by the Court.
- The Committee of Inspection has a number of duties and powers, which include advising or consulting with the liquidator on various matters.

Types of creditors

There are two types of creditors:

- A secured creditor – they hold a charge (for example a mortgage) over part or all of the company's assets. The rights of the secured creditor are set out in the document called a Mortgage Debenure document or Deed of Registered Charge. They have the right to appoint a receiver if the company fails to meet its obligations under the debenture or charge and this right continues if the company has been liquidated.
- An unsecured creditor – They have only contractual rights and those collectively arising out of a liquidation. Unsecured creditors have a number of rights when a company is wound up. These rights include the right to:
 - Share in any available funds after costs of liquidation and priority payments and secured creditors have then settled.
 - Take part in choosing the liquidator in the creditors voluntary winding up.
 - Attend and vote at meetings of creditors on various matters including the fixing of the liquidator's remuneration.
 - Take part in the appointment and be a member of the Committee of Inspection.
 - Receive information about the liquidation of the company including the sale of its assets and the way in which the proceeds are distributed.

Unsecured creditors should attend all the meetings called by the liquidator because this is the best chance they have of finding out what is going on and of having their say. In limited circumstances, unsecured creditors (as well as secured creditors) can sue directors of the company for losses if the company continued trading while it was unable to pay its debts on time (when it was insolvent).

BANKRUPTCY

What is bankruptcy?

Bankruptcy is a legal process that gives immediate financial relief to people with financial problems by stopping legal actions against them by their creditors. It is a legal process that is controlled by law. It usually results in getting rid of most of the person's debt and to those who cannot see their way out of a financial hurdle; this is often the best option to take.

Bankruptcy is the term used for individuals, rather than for businesses and companies. The term for businesses and companies is liquidation. The bankruptcy procedure is set up really with the purpose of giving the person with the problems a fresh start. It takes into account what that person owns and then these are split by a Court appointed person (the official assignee) and distributed amongst the creditors. If there are not sufficient assets to cover the creditors' debts, then the split is on a basis of percentage.

The law allows for both creditor and debtor initiation of bankruptcy.

Consult a lawyer or an accountant

If your business is in danger of heading into problems, which could lead to the liquidation of your business, as well as the possibility of bankruptcy for you personally, then you should seek professional advice as soon as possible.

When lawyers are talking about bankruptcy, they are really meaning that there is a situation where the person is unable to pay their bills when those bills have become due. As already explained, the term bankruptcy is generally applied to non-business type situations where the business is a corporate structure, such as a company. A sole trader and also a partnership, however, can go into bankruptcy and therefore it is considered in a situation where the business 'goes under'.

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Why consider bankruptcy?

Bankruptcy should only be looked at by a business owner in a situation where efforts have been made to keep the business floating and pay all creditors, but without success. It can mean that costs arising are compared to income coming in and the situation of the business, as well as the creditors, deteriorates. It is at that time that considering bankruptcy may be a more sensible option to pursue, rather than allow things to get worse.

At that point a business owner should contact their creditors and try to work out some sort of plan to make payment over a period to them. If this and another plan put in place to clear the debts of the business do not work, then talk to a lawyer about the necessity for putting the business into a bankrupt situation or liquidation.

While this process is not pleasant and it does require more costs and time in the sense of legal fees as well as court involvement, the final results may justify moving in this direction.

What bankruptcy will do

By filing for bankruptcy the following situation will probably result for the person filing:

- Stops all further action from creditors and gives the person breathing space.
- Stops foreclosure actions on the person's home or action against their assets.
- Prevents repossession of their vehicles or other property where money is owed.
- Stops harassment from debt collection agencies.
- Allows the person to challenge the claims of creditors who perhaps are seeking to collect more than the debt owing.
- Finally discharges all liabilities belonging to the person and enables a fresh start. Bankruptcy places severe restrictions on the financial and personal independence of the debtor.

What bankruptcy won't do

While bankruptcy will relieve the immediate distressed person of financial problems, it is not intended to cure all situations. For example, some of the things that bankruptcy will not resolve include the following:

- Discharge the rights of creditors who have proper security over the assets of the business or the person. That creditor will be entitled to take the asset because of the security held.
- May not discharge against some things the court decides should remain, such as child maintenance and alimony etc.
- Will not cover debts that are incurred by the bankrupt after filing for bankruptcy.
- Will not protect other people who are tied in with the bankrupt, such as those who have issued guarantees supporting the bankrupt.

Keeping honest

If a person is looking at bankruptcy this should not be used as a means to get out of responsibilities and to defraud the creditors of their rightful payments. The court is not a stupid and toothless authority, so it is not a wise move to try and be dishonest when it comes to the process of bankruptcy.

The courts are very strong on penalising and imprisoning people who use the bankruptcy legislation for their own means, if the case is not a genuine one. The law is specific in that the courts can go back for certain periods and recover money or assets that have been diverted to other people, so as not to be included in the bankruptcy action.

If there is any fraud involved in some of these situations, then the person may be subject to criminal charges. The policy is that once bankruptcy papers are filed, the person should be honest and open about all affairs so that the matter can be tidied up to the advantage of the person, creditors and others.

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CPA46867 11/06