Vital lessons in ASIC report go unlearned by SMEs

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There are vital lessons in the Australian Securities and Investments Commission (ASIC) 2015 report for owners of businesses who employ 20 people or less. Such businesses are accounting for 79% of the nation's insolvencies, some 85% of them with assets of $100,000 or less when they failed.

Of 8,354 failures analysed by external administrators, poor and frequently mismanaged cash flow often combined with extreme spending were cited as primary causes.

Australia's SMEs are owed $26b and newly published research by Intuit reveals 508 of them at the time they were contacted, were chasing an average of $13,200 in unpaid invoices. The survey also shows that a quarter of small businesses that don't insist on up-front payments wait more than a month past due dates on invoices to be paid.

Worse, 27% of business owners not requiring up-front payments, are having to take out loans or use credit cards to pay suppliers and employees. Yet there are so many basic things that can be done that aren't being done by SMEs to avoid situations like these that all too often put them on the slippery slope to insolvency at a rate virtually unchanged in the past three years.

Improving cash flow

Many businesses that pay for services on completion don't require customers to do the same thing. It's seriously retarding their cash flow.

If you're NOT doing the following in your business, Macks Advisory urges you to do so:

- Send a bill as soon as you've provided a service. Don't wait till the end of a month to bill customers. The longer you wait to send an invoice the longer it may take to resolve any issues relating to it – for example queries from customers who may have forgotten about something mutually agreed.
- Consider a cloud-based invoicing system that enables a bill to be sent straight from a completed job.
- Closely monitor debtors' accounts and accounts receivable. Too many people will try to delay settling their accounts for as long as possible yet invariably will pay the accounts from companies who puts most pressure on them first.

However, it's not necessarily the slowest payer who is the highest credit risk. Red flag for particular attention the debtor who's been a prompt or at least a reasonable payer, but has become increasingly lax about payments. Act to avoid bad debts.

Note this case study

The owners of a private tour company struggled to improve an invoicing system causing a dangerous cash flow problem.

This appeared to be a spectacularly successful business with a turnover that had quadrupled to $400,000 in the past two financial years.

Trouble was it operated three separate invoicing systems, none of which communicated with each other. Revenue came from many sources, some billed directly by one partner, some by the other partner, and others by office staff.

There was no coordinated attempt to see which invoices were being paid on time, which weren't – and if eventually, after how much delay.

Many accounts were months overdue, and accordingly the rapidly expanding business's cash flow was often close to being unable to support it.

Exacerbating the tour company's slow and cumbersome invoicing system was the complexity of dealing with some clients. Those on one-off visits to Australia presented few problems, but invoices for others that made multiple trips staying at differing luxury hotels that invoiced daily, were often difficult and time-consuming to monitor.

The partners, who were acclaimed tour guides, said the experience taught them that "while SME owners were responsible for everything, they can't be good at everything."

Believing increasing automation must be the way forward for many SMEs, they have now installed a cloud-based invoicing system that has not only solved a critical cash flow problem, but has also attracted new business worldwide.

"It makes us look highly professional; our invoices are generally for between $800 and $1000, and people from the other side of the world paying that sort of money need to feel confident dealing with us."

The why of business failures

Understanding why businesses fail goes a long way towards preventing failure. ASIC cites the following as prime causes of business collapses:

- *Personal withdrawals* from businesses cause most failures. From the start owners' business and personal accounts should be operated independently. Don't withdraw from a business account to deal with a personal "emergency". Only withdraw from a business account a "wage" commensurate with profitability.
- *Problematic cash flow* is indicative of an unhealthy business. Fix the problem or expect it to increasingly antagonise creditors and suppliers to an extent they turn against you and fatally wound the business.
- *Access to credit* periodically is essential for some businesses to stay afloat. Make sure it's available when needed. Lack of essential credit can create payment issues and supply delays that adversely affect other areas of a business.
- *Lack of current records* renders realistic budgeting impossible. Know the daily bank balance and what expenses will be this month. Stay on top of your business or a big pile of trouble will soon be on top of you.

In business there's always a risk of insolvency. Clearly trouble is looming when bills can't be paid on time. It's a situation that may be turned around if you **ACT** before it's too late.