Why companies fail: Part 1

Andrew Spring

Business insolvencies are a painful fact of life. The difficulty of succeeding in a complex and ever-changing market means that no venture, either new or established, is immune from the pitfalls that can lead to failure. In the first of two articles, Jirsch Sutherland Partner Andrew Spring outlines the key triggers that, when combined, frequently result in the liquidators being called in.

Failure to adapt to a changing environment

Like it or not, the world of five years ago is not the world of today. So failing to re-position a business to deal with a constant set of rapidly changing dynamics is a sure-fire recipe for disaster.

“Technological advances, particularly in terms of the online environment is a huge factor. Failing to take these into account is a huge problem,” says Andrew. “Many businesses struggle when it comes to finding the all-important balance between a physical versus a digital presence. Often, businesses that fail are those that haven’t understood or adapted to the changing ways their consumers want to interact with them.

“A rising preference for consumers towards online shopping is one example, but similarly business customers expect an ease of access to information, both pre and post a sale transaction. That could be quoting, logistics or invoicing; there is a lot of cost to a business in manually handling these types of enquiries.”

Failure to deal with offshore competition

While it once made sense for many Australian businesses to carry out manufacturing operations locally, the emergence of the global marketplace, free trade agreements and improved logistical solutions means that blindly sticking with that approach today is a path that will likely lead to ruin. That’s why failing to modify business models to accommodate this new reality could be a fatal misstep.

“Recently we had an example of a design, construct, install business that suffered from margin squeeze due to the high costs of manufacturing locally when compared to their competitors who were importing,” explains Andrew. “The inability to recognise this shift in the business dynamic and take steps to adjust their business model, in a timely manner, meant that by the point of realisation the hole was too deep to climb out of.”

Shrinking margins

A potentially serious issue with many knock-on consequences, margin shrinkage can easily occur if costs are inaccurately assessed when tendering for new projects.

“Having your margins squeezed is really tricky to come back from,” says Andrew. “Margin squeeze can ultimately turn what was a profitable project into an un-profitable one. Understanding your business costings is essential to avoiding margin squeeze. The knock-on effects can seriously impact cash flow, because you’re then having to fund that loss out of working capital. This may then affect your ability to undertake the next project. It’s a delicate balance when trying to manage resource utilisation, but as one of my mentors always said: ‘*Chasing sales is vanity, chasing profit is sanity’*.”

Poor financial reporting

A lack of robust financial reporting and forecasting models is often a key reason that businesses find themselves with squeezed margins. Without adequately understanding *how* a business makes money or whether it’s actually making money, directors and managers can find themselves in serious trouble.

“You can’t rely on your bank account balance to determine your true position,” says Andrew. “Being able to understand what the cash needs of the business are versus what its true performance looks like is essential.”

He says that such an understanding is vital for enabling managers or owners to make good decisions and avoiding catastrophic consequences such as poor cash flow management.

“If you have poor cash flow management, ultimately you can get to a point where you can’t pay your wages. This can obviously lead to business failure,” Andrew says.

“It’s vital to take action early and get ahead of the crisis; speak with your advisers such as your accountant or insolvency specialist and find out what solutions are available before it’s too late.”