

Submission

Small Business Restructure Practitioner and other matters 201012

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Summary

We face a unique situation in Australia where large-scale insolvencies are occurring in Australian small businesses not because of a lack of competence of business management but because of the restrictions imposed by governments in an attempt to control the Covid 19 pandemic. In this situation, small businesses need the opportunity and support to restructure and adapt, or close before the effects on their stakeholders become too severe. The draft legislation proposes the appointment of Small Business Restructure Practitioners to perform this function. However, it stipulates that only licensed liquidators may perform this role.

Experience and research in the USA and UK has demonstrated that a broad set of business skills is required for Small Business Restructure Practitioners to effectively restructure both the business and its debts to produce positive survival outcomes for the business. Given the skill sets required, licensed liquidators and accountants are insufficiently qualified to conduct restructuring for positive business outcomes.

Liquidators have a conflict of interest. They derive their profit from liquidating businesses, not from ensuring their survival. The current proposal would enable licensed liquidators to charge the \$20,000 restructure fee and use it as an opportunity to scope out which businesses would bring them the greatest profit if liquidated. Personal experience and reports of other small business owners shows that even before the Covid 19 crisis, licenced liquidators were pillaging small businesses in distress in a manner equating to piracy. Presenting them with a tsunami of businesses in distress can only result in large -scale, government-sanctioned piracy and an ensuing, massive Public Relations scandal.

With a prediction of up to 25% of Australian small businesses facing insolvency as a result of Covid 19 restrictions, the number of licensed liquidators is not sufficient to deal with the load. Under the current proposals, affected small businesses would be denied the care and support that they need to navigate this crisis.

It is therefore recommended that the registration of Small Business Restructure Practitioners include experienced Business and Commerce graduates (Bachelors and Masters qualifications) and that the Small Business Restructure Practitioners only refer

businesses to licensed liquidators when consensus on a restructuring plan for the business cannot be achieved and closure of the business by the owner is not feasible.

Further recommendations are made regarding the administration of the program and the importance of protecting the personal assets of the small business owners who find themselves in this situation as a result of government decisions beyond their control or reasonable ability to predict.

Introduction

Traditionally, the main reason for failure of a business was deemed to be poor management (1). However, small businesses in Australia are being subjected to events beyond their control that have adversely affected the viability of their business and are precipitating insolvency. The most notable of these are the restrictions associated with the Covid 19 pandemic.

Businesses in the hospitality sector have been deprived of customers and revenue. Businesses in the service and tourism sectors have been subjected to limitations in customer numbers that significantly reduce business revenue. Other businesses are suffering the flow-on effects of Covid 19 pandemic and/or restrictions in the USA, Europe and Asia. Although businesses have been supported in the retention of their employees and key participants by the JobKeeper package, JobKeeper is being reduced and is planned to be phased out in March 2021 despite the likelihood of further Covid 19 clusters and the imposition of further restrictions. To date, no vaccine has demonstrated an ability to protect against infection, shedding or the clinical signs of the SARS2 Coronavirus causing Covid 19, and the time of arrival of such a vaccine cannot be predicted.

The current business support programs (e.g. JobKeeper) have supported small businesses to the extent that business liquidations in 2020 to date have actually fallen compared to the previous year. Withdrawal of these programs in March is likely to trigger a tsunami of small business insolvency, prior to the availability of a protective vaccine. The further uncertainties associated with closures of State borders mean the current environment is a minefield for small business owners. The anxiety associated with insolvency, uncertainty, and the risk of losing their livelihood and assets is placing severe pressure on the mental health of business owners and poses an additional risk for family disintegration.

The competence of small business management in this insolvency scenario is not in question, so it is logical that the business continues to remain in the hands of the business owner. However, given the novel and extreme nature of the current small business environment, insolvent businesses are in need of urgent assistance and support on a scale not previously seen in Australia.

The legislation has been modelled on bankruptcy provisions in the USA that allow for a similar model. It is currently proposed that the Small Business Restructure Practitioner positions be limited to licensed business liquidators (Schedule 1, items 1 and 108, Section 456B and the table in Schedule 3 to the Corporations Act). Business liquidators in Australia

are accountants with experience in business liquidation. The tasks to be performed by the Small Business Restructure Practitioner are listed in 453E(1) of the Exposure Draft.

This submission demonstrates why business liquidators are the worst choice for Small Business Restructure Practitioners and recommends professions and processes that are more likely to produce the desired outcomes.

[Non-accountancy disciplines are more likely to produce survival outcomes in business restructure.](#)

Based on a review article in Eurofenix 2014 (1), in the USA, the role corresponding to the Small Business Restructure Practitioner proposed in the draft legislation is the Chief Restructuring Officer (CRO). CROs may be members of a larger restructuring firm or, more commonly, retired executives or individuals working as independent consultants who rely on the client company's management and workforce to implement the turnaround plan (1).

The CRO role is a corporate turnaround leader having financial, operational and management expertise, skilled in the complex and painstaking process of crafting consensus among all stakeholders around a common outcome (2).

The primary role of the CRO is to (1):

- Bring credibility, and objectivity to the restructuring process.
- Drive and create stability to the restructuring process.
- Build a consensus among stakeholders (shareholders, management, employees, creditors, etc) about the direction of the restructuring.

The appointment of a CRO also brings a sense of urgency to the restructuring process (2).

The CRO must possess a skill set that includes not only strategic but also operational and financial know-how if restructuring is to be meaningful and not simply a band-aid solution. A study by Deloitte in 2014 (1) described the skills most required by a CRO as:

Financial Advisor (17%),
Stakeholder Management (26%),
All Rounder (27%), and
Operational Skills (30%).

It was found that as time progressed, there was less reliance on financial advisory skills and more reliance on the capacity of the CRO to drive operational change and be all-encompassing (1). It is also important that the primary duty of care of the CRO is to the distressed enterprise and its Directors (1).

There is a paucity of published studies on the effect of appointing CROs, however, a study performed by Deloitte Touche Tohmatsu involved 71 distressed entities and the measure of success was the time taken for the share price to recover to a healthy level. If a CRO was appointed, the recovery time was 11 months compared to 26 months where no CRO was involved (1).

In a more recent survey, also by Deloitte (3), only 26% of the reported cases in 2013 used a CRO to support both financial and operational restructure while allowing incumbent management to focus on the day-to-day management of the business. While appointment of the CRO was influenced by creditors, it was ultimately implemented by the company. Creditors found CROs to be most effective when they were able to engage with the company for an extended period of time, as this helped the CRO to understand the business better and restructure it properly (3).

Having to do what is right for the business means focussing on operational turnaround (3).

Based on the CRO experience in the USA and in Europe, it is clear that the liquidator skill set is incomplete for small business restructure and less likely to produce prompt and positive outcomes compared to the use of practitioners with a more diverse, business-relevant skill set.

Liquidators are not adequately qualified to restructure small businesses.

The current qualification for a licensed business liquidator in Australia is an accountant with experience in business liquidation. To demonstrate these qualifications, the following is a list of course modules for CPAs in Australia who are trained in the following:

Core subjects:

Ethics and Governance
Financial Reporting
Strategic Management Accounting
Global strategy and leadership

Elective subjects:

Australia taxation (+/- advanced option)
Advanced audit and assurance
Financial risk management
Contemporary business issues – role of the CPA in contemporary business.

In comparison, **MBA** (Master of Business Administration) graduates are trained in the following:

Accounting
Banking
Business analytics
Business information systems
Business Law
Commerce
Human resource management and industrial relations
Finance

International business
Logistics and supply chains
Management
Marketing

Depending on the institution, some elective topics include: organisation cultural change, team skills and small business management.

Bachelor of Business (B. Business) graduates are trained in the following:

Accountancy
Advertising
Economics
Finance and financial planning
Human resource management
International business
Management
Marketing
Publicrelations

Bachelor of Commerce (B. Commerce.) and **Master of Commerce** (M. Commerce) graduates are trained in the following:

Microeconomics
Quantitative methods
Accounting
Macroeconomics
Finance
Organisational behaviour
Optional majors include: accounting, actuarial studies, management, finance, economics and marketing.

Simply restructuring the debt of a business does not include any steps to adapt the business product/services, marketing, HR, QA processes, premises and administration processes to prevent the debt recurring in the current small business environment. It is clear that the CPA is the least qualified of the above the professions to meet these challenges.

It is therefore recommended that the Small Business Restructure Practitioner should be a graduate with an MBA, B. Business, B. Commerce or M. Commerce qualification with a minimum of 5 years experience in business management roles. Previous experience in difficult business situations, including having a business liquidated also provides relevant personal and business experience and should not be an exclusion to registration as a Small Business Restructure Practitioner.

[Liquidators have a conflict of interest in restructuring small businesses.](#)

I have heard consistent stories about small business owners who have been through the liquidation process in recent years. Because of the mental anguish associated with

liquidation of a small business, the owners are reluctant to speak up, even in the face of their business and personal assets being pillaged. This is my story:

A few years ago, I had a business with a debt problem. I was referred by my accountant to a well-known, licensed firm to discuss administration and restructure. The firm required a substantial up-front payment. Once it was received, they declared that the business could not be salvaged - before they even had the financials - and proceeded with liquidation. They selected an arbitrary date from which they declared the business had been insolvent. They clawed back all the employee superannuation and taxes that had been paid since that date and paid it to themselves. They claimed the government allowances for payment of the employees – which the employees received – then also claimed a government payment intended to help fund the cost of small business liquidations. This they paid to themselves. They made no effort to verify the accuracy of creditor claims despite the fact that many were unsubstantiated or duplicated. When a buyer emerged for the business, they sold the business for less than 5% of its annual turnover and they increased their fees to include the proceeds of this too. The creditors essentially received nothing. The final report mentioned the up-front fee in small print at the end of the document and noted it as being unrelated to the liquidation process. I was subsequently advised that as the total debt amounted to less than 25% of the annual revenue of the business, the business could easily have been refinanced and rescued.

If supposedly licenced, reputable business liquidators were behaving like “pirates” raiding small businesses in difficulty prior to the Covid 19 crisis, why should we expect them to do any better when we present them with a tsunami of insolvent businesses?

Liquidators’ primary source of revenue and profit is the liquidation of businesses. Restructuring businesses to survive will provide them with less revenue and consequently less profit. However, the current proposals would enable business liquidators to be paid the \$20,000 capped fee to “scope out” whether or not the business would be profitable to the liquidator if it were liquidated. Recommendations regarding survival or liquidation of the business would be heavily clouded by conflict of interest.

Allowing business liquidators to be the Small Business Restructure Practitioners under the proposed legislation is likely to result in government-sanctioned small business piracy on a massive scale. When this eventually comes to light – and it will - the resulting enquiry or Royal Commission would make the Banking Royal Commission look like a polite discussion over coffee.

[There are not enough liquidators to deal with the impending tsunami of small business insolvencies.](#)

The number of small business insolvencies likely to occur once the government support programs are withdrawn have been estimated in the media as being anywhere from 100,000 to 500,000 businesses, or up to 25% of small businesses, over 2021-2022. Of the total 2,375,753 businesses actively trading in Australia in June 2019, 93% or 2,209,450 had a turnover of less than \$2m in June 2019 (4). This equates to a possible 552,362 small businesses with insolvency issues within the next two years. (5)

As at the end of September 2020 (5) the number of licensed business liquidators in Australia was 634. This equates to potentially over 800 cases per liquidator over a 2 year period. The liquidators are not distributed evenly, especially in the areas of most need. For example, with a high proportion of tourism and hospitality businesses, Queensland is likely to have a large number of eligible insolvent businesses, however there are only 106 licensed liquidators available to restructure small businesses.

It is clear that there are insufficient business liquidators to deal with this load. Small businesses in difficulty are therefore unlikely to receive the personal care, attention and expertise required to facilitate their survival.

Use of business liquidators should therefore be limited to businesses that have been found to be non-viable by the Small Business Restructure Practitioner and where liquidation is deemed the appropriate course of the action by the Small Business Restructure Practitioner.

Administration

It is clear that the proposed system will require close supervision by government to ensure that the objectives are being met. It also presents an opportunity for data collection to inform government regarding the status of small business in Australia.

Small Business Restructure Practitioners should be registered by government and be obliged to report KPIs to enable monitoring of the performance of the program. Relevant KPIs include:

Business owner suicide rate – warning – given the distress caused by small business liquidation, the number is unlikely to be zero. It is a useful measure of the effectiveness of the Small Business Restructure Practitioner.

Business employee suicide rate.

Proportion of businesses with a restructure plan agreed to by the business stakeholders.

Proportion of restructure plans successfully implemented.

Proportion of businesses referred for liquidation.

Proportion of businesses sold.

Proportion of businesses closed without use of a licensed liquidator.

Proportion of businesses still trading after 12 months and 24 months.

Additional data could be gathered on:

The primary sources of debt in the insolvent businesses.

Recommendations to change or improve government programs to support small businesses.

Owner liability

The conditions that are currently causing large scale business insolvency in Australia are beyond the control of small business owners. The restriction measures that have compromised these businesses were implemented by State and Federal governments. It is therefore inappropriate and grossly unfair for small businesses owners to have personal

assets seized and sold as part of the liquidation process of businesses that are deemed non-viable.

Moving home is considered to be one of the most stressful life events, ranking alongside long-term illness, loss of employment, bankruptcy and divorce (7). Research in the UK has shown that children who move home during the first year of life have a substantially higher risk of being admitted for emergency preventable hospitalisations (7). Moving home frequently during the primary school years was shown to have adverse effects on health outcomes and education results (7).

Home ownership also has an important welfare role, offsetting the demand for government welfare payments (e.g. income and rent assistance) not only in retirement but also during the working years (6).

It is therefore recommended that during the period of Covid 19 pandemic restrictions and for at least a 5 year period afterward that the provisions that allow liquidators to hold small business owners and directors personally responsible for business debts be suspended and that ownership of the family home and at least one vehicle be protected wherever possible to help maintain the integrity of families and prevent adverse flow-on effects on the mental health and welfare of family members, especially children.

Conclusions

The next two years promise to be the most devastating and diabolical for small business that Australia has seen since the Great Depression. With small business employing more than half of Australia's workforce, the effects will be felt throughout the economy. It is vital that businesses rendered insolvent as a result of Covid 19 restrictions and flow-on effects receive support and the opportunity to restructure or close as soon as possible.

It is clear that the proposed legislation has the potential to provide significant assistance and support to small business during this period. However, the information provided clearly demonstrates that not only are licensed liquidators the insufficiently qualified to provide restructure assistance, they also pose a significant conflict of interest that could result in large-scale, government-sanctioned piracy of small business. In order to mobilise an adequate and appropriately skilled workforce to assist and to maximise positive small business outcomes, registration as Small Business Restructure Practitioners must be opened to experienced business and commerce graduates.

The reforms also provide an important opportunity to gather information relevant to supporting small business in Australia.

Also, to reduce future burdens on mental health, health and welfare resources, it is vital that the personal assets of affected small business owners be protected. They should not have to pay with their personal assets for the decisions imposed on them by State and Federal governments in the wake of the Covid 19 pandemic.

References

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