



Submission
Insolvency reforms to support small business

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Financial Counselling Australia (FCA) is the peak body
for financial counsellors in Australia.

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About Financial Counselling Australia

Financial Counselling Australia (FCA) is the peak body for financial counsellors in Australia. We support financial counsellors and provide a voice on national issues. We also advocate on behalf of the clients of financial counsellors for a fairer marketplace.

What Financial Counsellors Do

Financial counsellors provide information and advice to people experiencing financial difficulty. Working in community organisations, their services are free, independent and confidential. Financial counsellors are required to hold, or to obtain, a Diploma in Financial Counselling. They need knowledge of a wide range of areas of law and policy, including consumer credit law, debt enforcement practices, bankruptcy, industry hardship policies and government concession frameworks.

Financial counsellors also document their experiences and highlight issues that have a negative impact on their clients. Either individually, or through FCA, they consult with industry, government and other stakeholders and to encourage practices that prevent financial and consumer problems in the first place.

About the Small Business Bushfire Financial Counselling Support Line

On 20th January 2020, in response to the bushfires that caused widespread devastation to communities all along the eastern seaboard and into South Australia, the Federal Government announced a suite of measures to support small businesses.

These measures included \$3.5 million to establish the Small Business Bushfire Financial Counselling Support Line (Small Business Support Line). On 18th March, the Support Line and accompanying [website](#) was [launched](#). The Support Line is operated by FCA.

Increasingly the Small Business Support Line is assisting small businesses affected adversely by COVID-19 and the resulting economic downturn.

FCA has long advocated for dedicated financial counselling support for small business owners, modelled along the lines of the United Kingdom's [Business Debtline](#), which has offered a similar service for many years.

About this submission

Financial counsellors are increasingly supporting small business clients. During June 2020 FCA and the Small Business Support Line ran a series of small business webinars for the broader financial counselling community around Australia. A poll from over 200 financial counsellors in attendance highlighted that business and personal debt is commonly entwined, with 42% reporting this was a common issue. 85% of financial counsellors reported having a client (individual) present with a small business issue in the last three months (72% within the last two months).

Since inception to end of August 2020 the Small Business Support Line has provided 260 cases of assistance to small business clients.

- 44% self identify as requiring support to access grants and loans
- 22% self identify as requiring help to manage their debts
- 10% self identify as requiring assistance with insolvency considerations.

In our experience clients seeking assistance with grants are doing so because they are struggling with viability and have debt management challenges. On this basis to the end of August 76% of small businesses contacting us for support are needing assistance with business viability/debt management or insolvency. These small businesses are owned and operated by people. They are distressed and overwhelmed by the situation in which they find themselves.

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1 THE COST OF THE INSOLVENCY PROCESS

We support the legislation's aim of reducing costs associate with the insolvency process.

We submit that consideration ought to be given to establishing a government funded corporate winding-up service analogous to that provided by AFSA bankruptcy trustees.

1.1. Costs as a bar to access

Many of our clients wish to retain control of their situation by taking the responsible first step of contacting an insolvency practitioner. They want to seek help with their company's financial difficulties, rather than waiting for creditors to force their company into the insolvency process.

Insolvency practitioners are commonly paid as part of the administration process, either out of the proceeds of realising company assets or by revenue generated through trading. However, where an insolvency practitioner is approached by an insolvent business without sufficient assets or revenue to provide such remuneration streams, the practitioner may instead require payment of their fees upfront (estimated at between \$5,000 and \$10,000).

The great majority of our clients' businesses cannot afford to engage an insolvency practitioner as they have insufficient assets or revenue. At the same time they cannot afford to pay practitioner fees upfront. Accordingly, they are excluded from the market for insolvency services. In our experience this causes considerable distress and anxiety for business owners.

In these circumstances, notwithstanding a genuine desire to take proactive and responsible steps to address insolvency, their only option is usually to passively wait for a creditor to force them into administration. In so doing, the company's financial situation further deteriorates in an uncontrolled manner, with greater losses being incurred to the detriment of the business and all creditors.

1.2. Costs as an inhibitor of returns to creditors

In addition, for small businesses that can afford to remunerate insolvency practitioners, either up front or as part of the administration process, the scale of fees charged can be disproportionately high in comparison to the returns payable to creditors.

This factor is a disincentive to retaining insolvency practitioners voluntarily, again increasing the likelihood of passive inactivity on the part of owners of failing businesses.

1.3. Government funded winding-up service for micro businesses

For both the above reasons, we submit that the success of the planned reforms in providing much needed access to insolvency processes for our client constituency will rise and fall on the degree to which the fees charged by restructuring practitioners are affordable. The complexity of even simplified insolvency processes, and the vulnerability of insolvent business owners, provides reasonable grounds for assuming asymmetries of information and bargaining power in the market for small business restructuring services will favour restructuring practitioners. Given this, we are not convinced that market forces alone will deliver sufficiently affordable fees.

For insolvent corporations at the very small end of the spectrum (for example, those with assets less than \$20,000 and revenue of less than \$100,000 p.a.) who do not plan to continue trading, we submit that consideration ought to be given to establishing a government-funded corporate winding-up service analogous to that provided by AFSA bankruptcy trustees.

2 RETAINING CONTROL OF THE BUSINESS

We support the legislation's aim of allowing owners to retrain control of their business through the new restructuring process.

Affordability will be key driver of accessibility.

2.1. Benefit of control

As stated above, most business owners wish to retain control of their business whilst tackling financial difficulties. One of the most common observations made by our clients facing debt recovery action from hostile creditors is:

- why are they forcing the company into administration?
- why won't they let me trade out of difficulty?

Creditors would get a greater return because company assets would not be eaten away by legal fees and the costs of insolvency administration. The perceived thoughtlessness

and inexplicability of such brute force recovery measures is a source of great bitterness and frustration amongst small business owners.

Retention of control of the business by the owner should confer economic benefits derived from the owner's intimate knowledge of operations and the relevant market, with such expertise and information enabling economically rational decisions to be made during the restructuring process.

In addition to the express economic benefits of retention of owner control are the emotional and personal benefits of granting an owner agency during a time of great stress.

Our experience highlights the great personal toll exacted upon the owner of an insolvent business – a toll that is levied also upon an owner's family. A business' financial difficulties may be amplified by the economic cost of handling the emotional fallout of insolvency: from the direct costs of psychological and counselling services to the less tangible costs of an owner's reduced productivity and personal capability.

Granting a business owner agency throughout the insolvency process may alleviate some of the emotional burden of financial difficulty (admittedly the experience will always be personally taxing) and reduce the associated costs.

2.2. Affordability

We support the new legislation's aim of allowing owners to retain control of their business through the new restructuring process. We reiterate our point however that the affordability of the process is a key driver of accessibility and this is itself a precondition to retention of control by owners. Control of the process, and of the decision to enter into the process, is key.

3 THE IMPORTANCE OF ASSESSING VIABILITY

We support the Australian Small Business and Family Enterprise Ombudsman's call for a Small Business Viability Review Program.

Understanding what information and records are necessary to consult in order to undertake a business viability assessment is an important threshold requirement of engaging with a restructuring practitioner.

Financial literacy levels are as variable amongst the business community as they are amongst the general public. In our experience many business owners struggle to

understand their business' financial position and require support to conduct even the most basic of business viability assessments.

Many business owners with limited financial literacy rely upon an accountant to maintain financial records and reporting. However, when a business falls into difficulty, the owner can no longer afford to pay that accountant and thus those services are unavailable.

To that end, we support the Australian Small Business and Family Enterprise Ombudsman's call for funding to be granted to a Small Business Viability Review Program which would grant small businesses subsidised access to tailored planning from an accredited professional which would assist an owner to assess the likely prospects of an attempt to trade out of difficulty, as against planning for an exit for the business.