



Australian Small Business and Family Enterprise Ombudsman

Discussion Paper: Insolvency Practices Inquiry

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By email: inquiries@asbfeo.gov.au

financialcounsellingaustralia.org.au | www.financialcounsellingaustralia.org.au

Level 6, 179 Queen Street
Melbourne
VIC 3000

Contact person for this submission

Fiona Guthrie
phone: 03 8554 6979
mobile: 0402 426 835

About Financial Counselling Australia and Financial Counselling

Financial counsellors provide advice to people with money and debt issues. Working in community organisations, their services are free, confidential and independent.

Financial Counselling Australia (FCA) is the peak body for financial counsellors in Australia. FCA's members are the State and Territory financial counselling associations.

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1 Introduction

We welcome the Australian Small Business and Family Enterprise Ombudsman's (ASBFEO) discussion paper – Insolvency Practices Inquiry (the "Inquiry").

2 Executive Summary

We support an inquiry into insolvency practices and the impact on small business. Insolvency can be difficult, costly and unfair for small business. Small business needs access to expert independent free advice to ensure adequate support. The costs of insolvency need to be reduced and the structure simplified.

3 Financial counselling and small business

Financial counsellors assist both people in financial difficulty, as well as owners of small business in financial difficulty. There is an obvious overlap between people and businesses. People own businesses. Business financial difficulty often means personal financial difficulty. For a company, the directors often sign director's guarantees which mean that company financial difficulty also means personal financial difficulty.

Financial counsellors assist small business people by:

- Negotiating repayment arrangements with creditors, including the Australian Taxation Office, commercial leases, loans, utilities and suppliers;
- Providing advice on options to manage financial difficulty;
- Providing advice on personal insolvency options and assisting people to declare bankruptcy (if this is appropriate);
- Representing people in external dispute resolution schemes with disputes and financial difficulty matters;
- Accessing resources that can assist, for example, determining whether the business is viable using resources provided by the Australian Taxation Office for this purpose;
- Referrals for assistance including free legal advice, tax help and other support services
- Providing advice, assistance, representation and support for personal debts that are often affected by small business financial difficulty.

Financial counsellors often see people when their business is failing, and they are in serious financial difficulty with both personal and business debts. This is a highly stressful time and financial counselling help can be critical in navigating the process of business (and sometimes personal) insolvency.

Appendix 1 includes some examples of the assistance provided by one financial counsellor to small business.

4 A National Business Debt Helpline

Currently, there is a National Debt Helpline for people to call to speak to a financial counsellor (often with additional access to a community lawyer). This is a free service with a free call number 1800 007 007. The Prime Minister recently announced the Small Business Bushfire Financial Support Line¹ which will be a dedicated single contact point for advice and support for small businesses in bushfire affected regions. The service will be staffed by small business specialist financial counsellors. This is a welcome resource for small business affected by the recent devastating bushfires.

There is still a service gap for small businesses however in having access to a dedicated national financial counselling advice line. It is noted that the UK has a Business Debtline already.² The UK experience indicates a clear need for this type of service in Australia.

A National Small Business Debt Helpline could be staffed by financial counsellors and community lawyers with expertise in small business and could provide advice on:

- Negotiating repayment arrangements for a tax debt, lease, utility, or suppliers
- Negotiating repayment arrangements for business loans
- Advice on the process for disputing a business debt that may not be owed in part or in full
- Disputing a debt in an external dispute resolution scheme (if the supplier is a member)
- Advice to, and assistance for, directors who have guaranteed a business loan
- Diagnosing the probable causes of business distress, such as cash flow issues, inadequate margins or high overheads
- Advice on the insolvency process and options
- Providing advice on the debt collection processes including court action
- Referrals as necessary

This would be in addition to the usual advice that financial counsellors give for personal matters. For many small businesses, personal debts are intertwined with the small business. Financial counsellors could then take a holistic approach.

We believe that a National Business Debt Helpline for Australian small business owners should be a priority to ensure that small business owners get targeted advice when it is needed.

5 Financial difficulty and small business

5.1 Financial difficulty and avoiding insolvency

A challenge for many small business owners is working out the difference between financial difficulty (or cashflow problems) and insolvency. Insolvency often means closing a business so it is emotionally difficult and stressful to make a decision about insolvency. Many small business owners believe that their problems are only temporary and they can survive with some help. Getting expert advice about what to do when in financial difficulty can sometimes be completely unaffordable. It also puts small business owners in an awful position of paying for expert advice instead of paying an essential expense (for example, a lease, creditors or home loan).

¹ See Media Release dated 20 January 2020 at <https://www.pm.gov.au/media/immediate-small-business-support-bushfire-affected-communities>.

² See businessdebtline.org.

Getting early and effective help with financial difficulty can mean avoiding insolvency. Any consideration of insolvency needs to incorporate this important point. Small business owners do not go into business to fail, they do not want to be insolvent. Getting help for a small business early means that the business can trade on and adding value for the owners of the small business, any employees and the wider economy.

This Inquiry is an opportunity to announce and campaign for a range of measures to assist small business to avoid insolvency. There are four key areas where small business could be assisted to avoid insolvency:

1. Support when a small business is starting.
2. Making sure early and effective expert advice is available to small businesses in financial difficulty.
3. Setting standards and expectations on making financial difficulty repayment arrangements. Considerable work has been done with banks on this point (for both personal and business debts) and this should be replicated across all debt types with an investigation on embedding the standards.
4. Making sure there is access to justice. The ASBFEO is still completing phase 2 of an Access to Justice Inquiry but a key outcome should be accessible external dispute resolution that is mandatory.

Each of these factors is discussed below.

5.2 Support when a small business is starting

There are extensive resources available to small business owners when starting a small business. We do not propose to cover this issue in any detail except to suggest that the effectiveness of the resources should be evaluated.

5.3 Getting help

Small business owners face the following problems when getting help with financial difficulty:

1. *There is very limited help available*

This is a significant problem. Small business needs to have access to advice on a range of areas at no cost (preferably) or at very low cost. Small business owners should not have to spend thousands on lawyers and accountants to get timely advice.

2. *It is difficult to find where to go for help and find the limited help available*

There is no really obvious structure on how to get expert advice and help. The ASBFEO and the Government has a lot of quality information available. However, small business needs access to expert independent professional advice. This way the small business owner knows it is not advice from the Government, but instead from an independent expert providing advice in their best interests (and free from conflict).

3. *Creditors can be unreasonable when making repayment arrangements and this can mean that the help needs get very complex*

This is a frustrating problem for small business. They seek help from an accountant only to find they now need a lawyer because of court action. Although this problem cannot be completely avoided, early multi-disciplinary advice may assist in managing debt enforcement action while dealing with cash flow problems (for example).

5.4 Standards for repayment arrangements

Considerable work has already been done on this issue but there are still a number of gaps:

1. Banks providing small business loan are subject to a number of standards but business finance does not have any similar standards;
2. Assistance by the Australian Taxation Office (ATO) is subject to non-transparent internal rules. There are no standards to be met and financial counsellors often report that when they represent a client the flexibility of the ATO vastly improves.
3. Commercial leases and suppliers continue to have no standards and financial counsellors report very unfair practices including being locked out of premises and forced bankruptcy for smaller debts.

We agree that the interests of creditors do need to be balanced when making repayments. We would argue that those interest are usually best served by the small business continuing to trade so its debts can be paid.

5.5 Access to justice

Access to justice continues to be a serious problem for small business. In our experience, most small businesses are forced into insolvency from collection of debts by creditors. The increasing pressure convinces the small business owner that the business is not viable. The difficulty is that it may have been possible to trade out of the difficulty in some circumstances if workable repayment arrangements were made with creditors. The small business also needs to be able to seek an independent review when creditors are unreasonable even when there is evidence the repayment arrangement would resolve a temporary problem and the creditor would later be paid in full.

The challenges with access to justice have been covered in the ASBFEO report *Access to Justice – Where do businesses go?*³. Phase 2 of this inquiry has not been completed yet. We look forward to the second phase of this process. Our observation would be that where possible, external dispute resolution must be implemented and be mandatory. For example, for small business loans only some business lenders are required to be a member of the Australian Financial Complaints Authority (AFCA). Small business should have the certainty that membership of AFCA is mandatory to ensure free access to justice in the event of a dispute (including financial difficulty).

³ November 2018 Available at <https://www.asbfeo.gov.au/justice-for-small-business>.

6 Small business experience with insolvency

6.1 Loss of control

Financial counsellors do work with some small businesses in the process of insolvency including closing the business (as it is no longer viable) or liquidation. In the experience of financial counsellors, small business owners find the insolvency experience awful. It is not just the failure of the business and sometimes facing poverty, it is the loss of control (any control at all) over the process. Small business owners can feel strongly about how their customers and creditors are dealt with in this situation. There are a number of common frustrations with insolvency that small business experience:

- Difficulty working out whether they are insolvent
- Being unable to afford professional advice because the small business is in financial difficulty and the owner is also in personal financial difficulty
- The complete loss of any control over any part of the process
- The lack of consultation or any clear explanation
- The excessive costs of voluntary administration or liquidation which often means creditors remains unpaid even if there are assets

Based on the feedback we have from small business (which we believe will be reflected in the ASBFEO survey) there are many aspects of insolvency for small business that could be improved.

6.1.1 Consultation question 1

At the initial consultation with a registered liquidator, should the registered liquidator be required to provide a small business with:

- a. A hard copy plan language fact that outlines the various types of external administration and the role of directors and owners in each?*
- b. The reasons for recommending a particular course of action to the directors?*

We agree that there should be disclosure and reasons for a recommended course of action. The small business needs to have detailed information with reasons so they can make an informed choice about the best option for them.

The fact sheet should also include the following information:

- The likely costs of each type of external administration; and
- The process available to complain about costs if excessive

6.2 Costs

The costs of external administration are often breathtaking compared to the actual income of the insolvent small business. It is incredible that a small business with income/profits for the owners is far below the up to \$800 an hour that receivers and administrators charge to wind up the small business. It is not proportionate.

The experiences covered in the Consultation Paper accord with the experience of financial counsellors talking to small business owners.

6.2.1 Consultation question 2

Should there be a control mechanism to prevent the total costs of an external administration from consuming the value of the company's assets? What form could this take?

Competition does not work well (or at all) in the insolvency space. The insolvency industry is an hourly charge industry and has not moved to delivering competition with fixed costs quotes. We believe that a control mechanism on costs would be useful. A review would also be good to consider a range of models for different sizes of small business. We would suggest a cap on fees for different sizes of small business.

It would also be desirable to consider ways to improve competition and innovation in the insolvency area. This could include reviewing the laws around insolvency to streamline the process where possible which would also reduce costs.

6.2.2 Consultation question 3

Should an information sheet of the average costs for a "day in court" and the average numbers of court days for particular actions, be included with each creditor's report?

This type of disclosure on costs can be useful. However, most small businesses are acutely aware that court is completely unaffordable and should be avoided. A better solution would be to restructure the process to avoid court and have some low cost arbitration process.

6.2.3 Consultation question 4

In consideration of technology available today, how beneficial would it be to automatically provide the Annual Administration Return report lodged with ASIC to creditors, directors, owners?

We cannot understand why this is not already occurring. Where possible documents should be provided automatically and electronically where possible.

6.3 Lack of transparency

We agree with the observations in the Consultation Paper. Small business owners regularly tell financial counsellors that the insolvency system is not transparent. Months go by and nothing happens. They call for an update and get charged for every call.

6.3.1 Consultation question 5

Should valuations be provided to, and proposed marketing strategies require approval from, creditors?

No comment.

6.3.2 Consultation question 6

Should demands to recover payments determined to give a creditor an unfair preference in a winding up require the registered liquidator to include the evidence they relied on in making that determination?

No comment.

7 Education of directors

We support providing education and resources to small business. As noted in the Consultation Paper, small businesses do not have legal departments. Further, they cannot afford the costs to consult a solicitor or accountant about many decisions. We would argue that the most effective education needs to:

1. Provide education and basic skills that is available before starting the business; and
2. Provide access to advice and targeted information when there is a problem.

We must stress that expert advice is education. Getting advice means that the small business owner is prepared in future.

Insolvency costs us all (the business, customers, creditors, the Government) a lot of money so it makes sense to invest money to avoid that cost. We agree it makes sense to provide some mandatory training. That training needs to be free so it does not stifle innovation. Arguably more important, is the availability of expert advice and information when there is a problem. For a well performing small business it is hoped that the expert advice can be accessed by just paying the large fees to get it. However, a business in financial difficulty may find it very difficult to access funds to get expert advice. That is why free or low cost advice needs to be accessible.

7.1 Consultation question 7

Should it be mandatory for individual seeking to be directors of companies to undertake core education on running a business and the potential risk of personal exposure before being eligible for appointment?

Yes, it should be mandatory and free. It should not be limited to companies but include all small businesses.

7.2 Consultation question 8

Should it be mandatory for individuals seeking to start a company or register an ABN to undertake core education on running a business and the potential risks of personal exposure to business?

Yes. See comments above.

8 Turnaround options

8.1 Debt vultures

As covered in the Consultation Paper, there are a range of services that prey on people and small business in financial difficulty. A large amount of work has been done by consumer advocates⁴ and ASIC⁵ warning people about these types of services. Small business is also at risk. Financial difficulty causes desperation and these services promise to fix problems. However, instead of fixing the problems, they charge a lot of money and leave the small business in a worse position as a pre-insolvency option. This often leaves the business with no option but to go into voluntary administration.

We believe that these types of services need to be regulated to protect people and small businesses from being ripped off.

8.1.1 Consultation question 9

Where a small business seeks advice when facing financial difficulties, should the individual proposing a course of action be required to provide the small business with:

- a. a hard copy plain language fact sheet that outlines the various types of external administration available and the role of directors and owners in each?*
- b. the reasons for recommending a particular course of action to the directors?*

We support this measure as covered in 6.1.1. The information should also include warnings and information on pre-insolvency options.

8.1.2. Consultation question 10

How can the safe harbour provision be improved to encourage small businesses to take action early and gain time to assess the viability of the business?

We support the development of a safe harbor for small business. We are unable to comment on the detail of how this might work.

8.1.3. Consultation question 11

How can accountants and bookkeepers best support small businesses to seek help early?

No comment.

⁴ See for example the campaign by the Consumer Action Law Centre and article at <https://consumeraction.org.au/stopdebtvultures/>.

⁵ ASIC Report 465, *Paying to get out of debt or clear your record: the promise of debt management firms* January 2016 available at <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2016-releases/16-011mr-asic-releases-report-on-debt-management-firms/>.

8.1.4. Consultation question 12

Should increased funding and resources be provided to the financial counselling sector to enable them to provide services to small businesses experiencing financial difficulty?

Financial counsellors already provide services to small businesses. Increased funding would assist to:

- Set up and offer a Small Business Debt Helpline for small business to get free advice;
- Increase expertise in all aspects of financial difficulty and small business.

Financial counsellors already have strong expertise in personal bankruptcy. Financial counsellors could also build further expertise in small business insolvency. It is expected that specialist small business financial counsellors will also build this expertise on the recently announced Small Business Bushfire Financial Support Line.

There is no doubt that small business needs expert free help when in financial difficulty. Financial counsellors (with additional funding) can continue to build capacity in this area.

9 Mental health

We agree that financial difficulty and insolvency can have a profound effect on the mental health and well being of a business owner. We support the *Insolvency Mental Health Awareness Program* and other ongoing efforts to provide support for people experiencing mental health problems. We do want to stress that in our experience, stress causes a wide range of health problems (not just mental health problems). Many small business owners have told us about heart attacks and other chronic and serious illnesses that followed the stress of financial difficulty and insolvency.

9.1.1 Consultation question 10

Should the impact on the mental health of small business owners and directors be cause for a pause in proceedings?

There should be flexibility inbuilt in the proceedings to deal with illness (including mental illness).

9.1.2 Consultation question 11

Are there other changes that could assist the parties where there are mental health issues?

We believe the best approach is to make the insolvency process significantly less stressful.

10 One size fits all

As we have already commented, we support innovation which would make insolvency more streamlined, less stressful and a lot less expensive. We support a tiered structure with various short form processes that are inexpensive. Reducing the costs of insolvency would assist the insolvent small business, customers, creditors and reduce costs to the Government (in charity and welfare).

10.1 Consultation question 15

General submissions are sought on the fairness of having one system and the benefits and risks of implementing different processes, so the costs and time to complete an external administration achieves the optimum outcome for creditors, employees and the company.

It is not fair to have a one size fits all system. Insolvency was developed for medium and large businesses. It was not and is not tailored to the needs of small business. It is heartbreaking for small business to watch all the money in the business go to a liquidator or receiver. Reform is urgently needed.

Appendix 1 – Experience of one financial counsellor in relation to small business

One business that I assisted had three business in Queensland and lived in Victoria. One son in Queensland looked after one business and the client commuted up and down as required. The clients were at risk of losing personal assets which included their home and all of the businesses due to lack of advocacy skills to get through a tough period. One tenant left one of the businesses which caused a deficit in cash flow. I discussed the situation with an insolvency practitioner who visited the client with me and we discussed all options and the insolvency practitioner and I felt that there was a chance to save this business. I worked with the client on a recovery plan and achieved some financial relief through advocacy. Two of the businesses were put onto the market and sold, creditors were communicated with and the third business continued to operate and all personal assets were kept. Business assets were sold and creditors paid out through full and final payments. Son continued to operate one business and the other partner found alternative employment in Victoria.

When I initially went to visit these clients, they were very unwell and could not see any light at the end of the tunnel. I still see these clients from time to time and they always stop to speak to me and advise that I had saved them and their marriage and can never thank me enough for the assistance and support. They have now started a new and very successful business which they advise that could never have happened if they had not had the help of financial counselling. They can now advocate for themselves when they need to and know that the financial counsellors exist if they need further assistance.

I have been to the homes of business people who have not been able to pay for personal costs such as utilities, rates, food and have never been in this position before and find it very hard to ask for assistance. It is usually the bank threatening foreclosure of personal assets that force the clients to look for help. Business people cannot afford to pay for services when they are in financial hardship as they stop paying for their own personal costs to try and keep the businesses going. It is quite a round-a-bout. Many are unaware of help available and do not know where to go. I have seen many businesses close their doors in (town) recently, there are many empty shops and some owners that I know now have their homes on the market. (tells its own sad story). It is not only the business closing but also employees losing their jobs which flows onto family financial stress which then require further services within the community which are also stretched to the limit.