

# Guide to Exiting Your Business

## INTRODUCTION

Sooner or later most business owners come to a time when they will start to think about moving on and exiting from their business. Regardless of your reasons and the strategy you chose, you will undoubtedly improve your outcome if you seek professional advice along the way.

There are many reasons behind the decision to leave a business. Some of the more common reasons given by business owners are:

- It's time to retire.
- Someone has made an offer for the business that is hard to refuse.
- They want to make a change in direction or involvement.
- The business has been very successful and the owner wants to cash in on its goodwill and success.
- It's time to pass the business on to family members.
- They have new plans and want to sell the business and use the cash for other purposes.
- There have been changes in family circumstances, such as illness.
- There are changes in the business owner's circumstances, such as illness or old age.
- The owner is moving out of the area.
- There have been changes in the marriage situation such as divorce.
- The owner is faced with increased competition and decide that operating the business is becoming harder and harder.
- After the loss of a key staff member, the owner decides it's becoming more and more difficult finding good staff and managers.
- The owner is simply tired and it is time to have a short break before he gets too old to enjoy life.
- The business is failing and it is time to get out.
- The business has failed and bankruptcy and liquidation is the only alternative.

## Ways of exiting

The several ways in which the owner of the business can exit from his or her business includes the following:

- Selling the business – Sell the business as a going concern.
- Passing the business on – Pass on the business to family members or other stakeholders.
- Merging – Merge the business with others.
- Closing down – Close up the business, sell off assets and stop trading.
- Liquidating – Liquidate the business and sell off assets.
- Forced closure – File for bankruptcy (if not a corporation) or liquidation (if a corporation).

## SELLING THE BUSINESS

### The important decision

If your business has been any sort of a success, you probably had to pour most of your resources and a lot of time and heartache into your business. A lot of businesses involve family members, so often it is the main subject of conversation around the dinner table or even on holidays. A business is therefore considered a big part of the owner's and owner's family's life. It may be difficult to imagine life without the business.

On the other hand, your attitude may be that the business is a 'pain in the neck' and has been a source of unhappiness for many years and that it is now time to get rid of it.

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Whatever the business owner's situation, selling the business is still one of the most important things that they will ever do because unlike other decisions that have been made over the years this decision is a final one and there will be only one chance to put the anticipated price tag on it. The owner will want to come out well ahead financially of course, and so will want to negotiate a price in satisfying terms and meet all the reasons for selling out.

The major issues that need to be addressed when it is time to sell your business include the following:

- Valuation of the business – from the owner's point of view, the aim is to maximise the gain that is obtained from the disposal of the business, but is constrained of course by what the market perceives as the value.
- Who will buy? – the owner may need to consult a business broker or other professional to arrange the sale so that it is put before as many potential buyers as possible.
- Selling issues – all the issues involved in the sale, such as the time to sell, what is sold or what assistance to give after the sale will have to be settled.
- How the deal is structured – the terms of the deal such as payment terms and taxation implications will need to be brought into the calculation.
- Financing the sale – a decision has to be made as to whether the owner will leave some financing in the business or whether this will be a clean all cash deal.
- Completing the sale – the full process from the initial letter of intent through to the final closing of the deal should be made very clear to the owner so that there is no room for confusion.

## **Make the offer known**

There are a number of ways to let buyers know your business is for sale. The best channels will depend on the business and the circumstances but the following methods are among those that are commonly used:

- Use of business brokers or real estate agents.
- Newspaper advertising.
- Trade publications and other trade contacts such as suppliers, distributors, manufacturers etc.
- Word of mouth.

Each method has its own advantages depending on what you are looking for but the seller should decide on whether to reveal the pending sale to their customers, employees and suppliers before the sale is completed.

Sometimes prior publicity of the sale can harm the future of the business making it less attractive to a prospective buyer and less profitable to the seller. One of the best ways to arrange a sale is to deal through business brokers or real estate agents who specialise in selling businesses because they can handle the complete transaction confidentially and professionally.

The agent should have wide contacts locally and be skilled in assessing potential buyers and screening them to find those who are legitimate and those who are just wasting time. They should also be thoroughly familiar with the business itself and must do everything possible to bring the buyer and seller together to finalise a mutual agreement.

## **Handling buyers and closing the sale**

The seller's ability to present the business in the right way and handle the transaction properly will enhance the chances of obtaining a good price and protection.

The seller should do the following:

- Consult a competent accountant and lawyer and discuss their requirements.
- Define the strong points of their business so that these can be emphasised in negotiations.
- Make sure that business records are tidy and complete and available for inspection when necessary.
- Ensure that time is not wasted on non-serious buyers and those without sufficient capital or the background and experience to carry on the business.
- Check the track record and reputation of the serious prospects because if the next owner fails to make a success of the business it could mean final balance owing to the seller may be lost
- Check the proposed financing arrangements and ensure these are clearly outlined in the agreement.
- Make sure that other matters such as the transfer of the lease and transfer of hire purchase agreements on assets etc have been cleared. If not cleared, an adjustment should be made in the calculation of the purchase price
- Close the whole deal through a competent solicitor and obtain professional tax advice as to the tax implications by correctly structuring the arrangements.

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## **Main points when selling**

There are really three questions that must be clearly spelled out when you are looking at selling an established business. These are:

- Why your business is for sale
- How much is it worth
- How is the sale to be finalised

## **Reasons for selling**

The important question when looking at selling an established business is being clear on your reason for selling. There are many valid reasons that bring a business on to the market.

Some of these are – Genuine (to the buyer):

- Retirement of the owner because of age or ill health.
- Another opportunity that has come up in a different field and therefore the present business needs to be sold.
- Advancement of new technology may also bring an owner to the conclusion that he is unable to cope with the latest changes and thus prompts him to find something else simpler and not requiring as much energy.

Suspect (to the buyer):

Remember that, a buyer would be naive if he does not also look at other reasons, which may in fact be the real cause for an owner selling.

- Declining business,
- Changes in the character of the neighbourhood with reduced need for the business goods or services
- Influx of new competition affecting turnover
- Highway construction coming through the area thus changing exposure and accessibility of customers,
- Expiry of a lease or franchise
- The facilities becoming obsolete and thus not being able to be efficient enough to complete
- The bad reputation of the owner which may have caused a drop in sales
- The rent is up for review and will be due for a high rise
- A new shopping centre is being planned a short distance away and this will affect the future of the business.

There are many reasons that a seller could offer and the cautious buyer would assess fully the situation before committing to buy. This assessment may involve canvassing the area to find out from other traders what is happening and having discussions with the local council and real estate agents as to proposed changes, which may affect the operation.

The reasons for selling therefore need to be in order so if you are selling up, be aware of this.

## **What is your business worth?**

Over a period of time an industry usually develops its own rules of thumb by which a business is to be valued. For example supermarkets may sometimes be valued at say, 5 weeks turnover so that if a supermarket had \$20,000 sales per week then the value would be about \$100,000. These are just rules of thumb or formulas that can be used to arrive at the approximate value of a business.

The sale of a business involves a long-term investment of both time and money by the buyer with no immediate guarantee of return. Therefore one of the most important things that must be considered when calculating the value (and thus sale price) of a business is its future earning profitability. This is the main point in assessing the attractiveness of a business and it should be the basis on which the selling price is weighed or measured when considering fairness and acceptability.

To estimate the potential earning power of the business the buyer will try to find out about past profits, past sales and operating ratios. To evaluate all this information properly the buyer may need an experienced accountant who can investigate and analyse this information. The accountant will need to obtain copies of financial statements and other records of the business for the past three years plus the income tax returns for the business to make sure that the figures being shown have also been the figures that have been supplied to the Tax Office.

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## What will the buyer analyse?

A detailed breakdown of sales and operating costs for the past years can be analysed by the potential buyer to indicate the trends in the business. They will then be compared to other similar businesses in the same trade. The buyer is well aware that there are people that 'cook the books' when they are looking for a sale so approach the sale with honesty. Don't be convinced the buyer will buy if you simply produce an impressive looking balance sheet (such financial records are useless if the business has suddenly collapsed for instance).

The buyer may believe that records have been arranged to suit the seller's purpose. Show business tax returns to prove that tax has been paid on the high profits that are claimed to have been earned. Don't give evasive answers to the buyer's questions. Don't give excuses. The potential buyer will know that refusal to give full explanations and information, or to have figures audited or examined by an independent adviser means it would be better to walk away and cancel the whole deal.

## What the buyer will check over

The first thing that a buyer must do in assessing the business that is available for purchase is to review its track record and history and the way it operates. This includes a full investigation of the financial records, as well as its staff, customers, suppliers, competitors and its marketing procedures.

The things that the buyer will look at are:

- Financial records.
- Debtors and creditors
- Staff.
- Customers.
- Premises.
- Location.
- Competitors.
- Lease.
- Patents and trademarks.
- Outstanding legal matters.
- Insurance.
- Marketing methods.
- Licenses and permits.
- Stock (inventory).
- Assets.

## Three things you'll want from buyers

A seller is not obliged to complete a deal with a buyer without knowing a little about the buyer's background and the ability to meet commitments. If the seller is financing part of the price, (leaving some finance in), then it is important that the buyer is someone of means and of good reputation and name. The seller will be concerned that the buyer is the right person, otherwise the buyer could destroy the business and any seller finance could be lost.

It is up to the business broker to provide details to the seller about the buyer's situation.

There are three main things that the seller requires from the buyer:

- Background and financial position – the seller must be convinced that the buyer is someone of good standing who will take over the business and look after the clientele and staff in the normal way. If the buyer has been a bankrupt or has a history of business collapses, or perhaps a criminal record, then these matters will be of concern and will affect the seller's decision to proceed or to close off negotiations. The buyer needs to provide evidence to the seller via the broker of financial net worth. This is the case especially where there is a substantial amount of money involved in the transaction.
- The seller wants a good offer – the seller of the business will want as high a price as possible and the buyer naturally will be wanting to outlay as little as possible. During negotiations the parties should really arrive at a fair offer that can be taken as the fair value of the business and which both parties are happy with. This fair offer may differ dramatically from the price originally listed and may be influenced by the appraisal of the business by the broker or by a separate valuation that has been commissioned by the buyer. In any event the deal will have more chance of succeeding if the offer is a fair one.
- A good deposit – the buyer must be able to put down a fair deposit in order to obtain the confidence of the seller. Generally a deposit of up to 10 per cent of the purchase price is expected. If the deposit is too low, then the seller will always feel that, should the buyer breach obligations, the amount at risk is not sufficient for the buyer to comply with the terms of the contract. For a seller to be seriously interested, the buyer must make a commitment by coming up with a reasonable deposit.

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## **Due diligence – what it is**

Due diligence simply means everyone doing their homework and checking the business out. This is the legal term that professionals use which, boiled down, amounts to using common sense to look at all areas of the business to see if it is the sort of business one wants to buy.

Due diligence will involve a more detailed investigation of every area of business starting from the financials down to production and even such things as who and what time the business is opened and closed.

Due diligence is usually carried out by the potential buyer, as well as the buyer's accountant and other business advisers. There are many businesses that go to the stage of due diligence only to fall over because things are revealed on a closer investigation that were not obvious at the initial discussions and negotiations.

Unfortunately there are many sellers who make false representations, especially in the area of financials. At a proper due diligence meeting the financial figures don't always line up with that which was initially given to the business broker by some business owners. It is a good idea at due diligence for the buyer to have a look at the business plan to see how the actual operation ties up with business planning projections.

It is important to be aware of the buyer's requirements when it is time for due diligence. Everything should be available and tidy as this will generate confidence in your business and hopefully speed up a sale.

## **How is the sale to be finalised**

The seller will want the greatest return for the years of hard work put into the business in the past. The buyer however is interested only in the future and thus both parties can put a different price on the same business while both are being quite reasonable. Negotiation between the two parties is the process by which the gap between the two different prices narrow.

Before carrying out the final negotiations the buyer will be fully aware of the book value of the assets and the maximum amount of money that he or she can pay for the business to obtain a return on the investment required. The investment return needs to equal or better the buyer's salary plus a return on the equity. Negotiations will, as a rule, start at a price lower than has been asked.

Remember that negotiations will not be entirely in money terms. Other details such as the name of the business and job security of the staff etc should also be brought into discussion. Other main points to be finalised include terms of payment, assistance by the seller during transition, and the conditions and terms to be included in the contract for sale and purchase.

## **Terms of payment**

It may be best to put a low value on the assets (stock, plant etc) and make the goodwill figure a high amount because goodwill is not taxable as such. The buyer however, will try and get the reverse (that is high value for assets and stock so that they become a tax-deductible item and a low value for goodwill because this is a non tax deductible item – note Capital Gains tax).

One way of bridging this conflict between the two parties is to have the assets valued highly and then the seller work in or act as a consultant to the new firm after the new owner has taken over. The wages paid will be tax-deductible to the buyer and the seller will have to pay tax on income, but because of this saving to the buyer it may be possible to give the seller a higher wage to make up for the tax paid. Usually in finalising the terms of payment the two parties through their accountants arrive at a fair compromise.

## **Assistance during transition**

The buyer may want to have the seller assist for a short period after the sale so that the new owner can be introduced to important customers and be shown the procedures of how to operate the business in the most profitable manner.

## **The sale and purchase agreement**

As a safeguard against any costly errors, legal advice should always be obtained before any agreement is made up and signed. The agreement should always be drawn up by a lawyer to ensure that all essential points are covered and that both parties know exactly where they stand. Among some of the points that should be included in a typical sale and purchase contract are:

- A description of what is being sold.
- The purchase price.
- The method of payment.
- A statement of how adjustments are to be handled (for example as to stock).
- The buyer assuming responsibility for the business from a certain date.
- Warranties by the seller, if any (for example as to protection for the buyer against any false statements or inaccurate information supplied).
- The covenant of the seller not to compete within a certain time period or within a certain area.
- The time, place and procedure for "closing the deal".

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## Arriving at the price

The matter of a fair price is a question that always provides the biggest problem when the business is to change hands. Methods of valuing a business are covered elsewhere in the material and will not be covered here. Valuation should always be carried out professionally to protect the interest of the seller.

## CLOSING DOWN THE BUSINESS

Closing down simply involves closing the doors, selling off all the assets of the business, paying off all the debts and whatever is remaining goes back to the owners. This is not a usual choice unless the business is not doing very well. If the business is a successful one then the owner will obtain far better value from the business by selling it off to a new owner so that they are able to obtain not just the value of the assets less the liabilities, but also value of the goodwill, which is probably the highest value in the whole price of the business.

The scenario for closing will often be:

- Set a date for closing and cut-off of everything.
- If the business has a lease or premises, then arrange it so that closure is at the end of the lease, or come to an arrangement with the landlord.
- Advise all suppliers and associates that the business will be closing on such-and-such a date.
- Advise all customers of the same details, although make sure that they are advised a few days before actual closure so that the business obtains maximum benefit of profitability right up to the time that the doors are actually closed.
- Sell off all the assets of the business and pay off all the bills.
- Arrange for everything to be disconnected, such as telephone, power, etc if applicable.
- File all the necessary returns and financial accounts through your accountant.
- Close the doors, take the balance of the money remaining after paying all the debts and go and have a holiday.

## PASSING ON THE BUSINESS

### That is – succession

If the business is a family business, which has been in the family for many years, then the current owner may wish to just pass it on to the next members of the family. Generally the family as a whole have a strong desire to see the business kept within the family group and passed from one generation to the next. Succession is a process that requires proper planning and teamwork between the owner and family members.

Whatever changeover is involved, the important thing is to preserve the ongoing viability of the business and to make it appear to the rest of the world as if nothing really has changed. The worst thing that can happen with old owners moving out and new family members taking over, is that customers may perceive it as a changing of the guard and may decide to take their custom elsewhere if they feel that the leadership that they had been so used to and respected has now gone.

Succession of course can also mean the sale of the business to loyal employees or to others like that who have worked with the owner for many years and are entitled to have first choice of taking over the business with the owner gone. However, the greater incidence of succession involves the transfer of ownership to the family so that everything is kept within the family.

Generally a succession plan will have two main factors:

- Transfer of power – the management and control of the business is transferred over to the 'anointed' family member chosen.
- Transfer of assets – the wealth concentrated in the business operation is transferred to family members in the normal way.

When transferring a family business from the older generation to the younger generation, the older generation must get the value they deserve out of the business. This is one of those important questions that have to be "nuttet out" between the parties. One of the best ways of achieving full value for the older generation is simply selling the business off to family members.

In this case a proper professional valuation will need to be put together so that both parties are happy. If selling the business in this way, it is important before the completion of the sale to organise what structure the buyers will run the business under. For example, if the new bosses are the children in the family, then forming a family trust to own and operate the business would be an option that should be considered because of the tax implications and other advantages.

This type of procedure is often used where the owner may want to gift the business to the children, yet still run it through a family trust, to enable proper structuring for the maximum benefit of the new acquisition.

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## Passing it on? – plan now

Many business owners find the fact of the eventual mortality unnerving. They know that sooner or later they need to put together all that is required to pass the business on, but they put that day off to a later time. What they miss is that when a business owner plans for tomorrow, the business increases its strength and therefore its chances of survival. Some statistics from studies done in the USA are interesting – they show the following:

- 95 per cent American businesses are family owned.
- Of these 95% only about 30% survive the second generation.
- Only 10% survive the third generation.
- Just 28% of family owned businesses have developed some sort of succession plan.

These low succession results point to the need to plan succession early. In order to create a smooth succession there are a number of factors that should be considered.

These factors are:

- Family – to avoid any sort of favouritism many owners leave their businesses to their children, all in equal shares. Unfortunately, what happens is those family members often don't see eye to eye and the differences of opinions and arguments can end up hurting the business.
- Qualification – the succession plan should set out that taking over the business by children should not be a right, but should be earned. That is, the successor needs to qualify by having the experience and hopefully working their way up in the business.
- A Board – before the business is handed over, it is advisable to set up a Board of Directors consisting of non-family members. The incoming family owners should then take advice from the Board and because they are not involved in the family the business is strengthened and hopefully a lot of the problems that come through family arguments will be taken care of.
- Take your time – plans for succession cannot be put together in one day. It needs to be well thought out and the replacement managers must be made very clearly aware of their responsibility in continuing the business along the same successful lines as it has been done in the past. The new family managers should understand that full control would be passed over little by little as they prove themselves.
- Don't delay – It goes without saying that the sooner a succession plan is put together the better. It should be one that is flexible enough to be changed as circumstances dictate. For example, parents seem to have already made up their mind that their children will succeed them in the business. However, the children, as they grow may not want to be part of the business as they have their own dreams.

There are obviously many problems that arise when there is a need to put together a plan so that others can take over the operation. The reality is that family members don't always agree and that what the parents have in mind don't always coincide with what the children's desires are.

In any event, planning with whoever is being groomed to take over the business should start early.

## MERGING

### What is a merger?

A merger theoretically is when two companies agree that they want to go forward as a single operation rather than being two separate entities. Mergers are often driven by the competitive landscape. When times are difficult, strong companies seek out other companies to see if the combination of the two will create a more competitive, cost efficient operation than either one currently is. The stronger of the two companies will gain a greater market share and achieve greater efficiencies perhaps through such a deal. A merger may also be advantageous to the weaker company who is well aware that they are unable to survive independently.

### What happens?

Often what happens is that these parties contact one another to see if a merger can be effected and to see if some of the business and staff can be retained.

A merger does not necessarily involve equals. If one company is much larger or smaller than the other a merger can still work. The whole idea of the merger is that the CEOs agree that continuing the business alone is not the best thing for either company, but by merging with each other both should benefit.

Some of the benefits come through from efficiency gains resulting from combining administration and other similar functions. There will also be better cost efficiencies and the combined group will end up with a much higher profile in the industry, which gives more confidence to those with whom their new operation deals.

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## What is an acquisition?

An acquisition of one company by another is a little different from a merger but does not vary by much. All of the above reasons for combining the two companies apply, but instead of swapping stock or consolidating under a new corporate entity, one company simply buys the other company out. Sometimes it is done in a friendly way and at other times it is described as 'hostile'. Another name for the unfriendly acquisition is 'takeover'.

In an acquisition a company can buy another company out with cash or with stock, or with a combination of the two. The difference between the merger purchase and an acquisition purchase depends on whether the purchase is friendly and announced as a merger, or whether it is announced as an acquisition and whether the purchase is unfriendly, in which case it is always called an acquisition.

## LIQUIDATING

### What is liquidation?

The term liquidation applies only to companies, whereas the term bankruptcy applies to non-companies such as a partnership or sole trader. Generally liquidation occurs when the creditors of the company (those people to whom the company owes money) pass a vote to have the company liquidated. This is usually after a period when the company is under an administration where a separate person called an administrator runs the business to see if something can be salvaged. A liquidator can be appointed by the court following an application by one of the creditors to wind up the company operation. Once the liquidator is appointed, he or she has the duty to all the company's creditors of equal ranking collectively and not just to any particular creditor who filed the application for appointment.

### The liquidator's job

The liquidator has certain functions, which are required under law, including to:

- collect and sell all the assets of the business.
- investigate and report to the creditors about any matters to do with the operation of the business, as well as the reasons for the company failing.
- meet all the costs of the liquidation and also setting out who gets paid first.
- distribute all funds to creditors and, if there is any excess, these will go to the owners of the company.
- report to the authorities, as to the conduct of the affairs of the company by its directors and officers, and
- apply for the de-registration of the company when all is finished and the liquidation is completed formerly.

### Paying the liquidator

The company pays the liquidator from its assets. If there are insufficient funds or no assets, then the liquidator can remain unpaid unless there is an agreement for the creditors to meet the fees. On some occasions the liquidation cannot proceed because there are no funds to conduct it. In some cases also application can be made to the Court for payment of the liquidator so liquidation can proceed.

The liquidator is paid at a rate, which is usually approved by the creditors.

### Rights of creditors

Creditors of a company are paid in order of priority as follows:

- Secured creditors first.
- Unsecured creditors second.
- Shareholders last.

Any secured creditors who hold a security, such as a mortgage over any of the company's assets, are paid first. Unsecured creditors are then paid out if there are sufficient funds. If there are not sufficient funds, then payment is made on a pro rata basis. Finally, if there are funds in surplus then payment is made to return capital to the shareholders. It should be noted, of course, that the costs of the liquidator are met even before the secured creditor is paid out. The liquidator of course will try to obtain as much money as possible from the company, including suing the directors of the company through a creditor if the directors have been negligent and continued trading even when the company was insolvent (that is, unable to pay its debts on time).

Liquidation should only be considered as the last resort. It really only applies when the company cannot pay its debts when they fall due and its shareholders, creditors or the Court finally has to put the company under the control of an independent person whose job it is to close the business, sell off the assets, pay off the remaining debts and return whatever is left to the shareholders. Often there are insufficient funds to meet all debtors.



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## Liquidator's rights and duties

The regulatory body sets out clearly what happens in a liquidation and the rights and duties of the liquidator who is the controller of the company.

- The most common form of liquidation occurs when creditors vote for liquidation of the company following a period when it is under administration or, where after a period, the company has failed to meet a court recognised demand for payment. The Court, usually following a creditor's application to wind up a company, may also appoint a liquidator. The liquidator has a duty to all the company's creditors, not just the ones who appoint him/ her to administer and arrange the payment of all liabilities.
- Creditors may agree to indemnify or reimburse a liquidator for costs and expenses if they believe the liquidator can recover further assets for their benefit by undertaking other enquiries. On such occasions after recovering the additional assets the liquidator or creditors can apply to the Court for an order to compensate the indemnifying creditors for the additional risk in funding the recovery by the liquidator. If there is insufficient or no assets the liquidator remains unpaid unless the creditors agree to reimburse them.
- The liquidator is remunerated at a rate or a fixed amount approved by the creditors, the Committee of Inspection comprised of creditors or by the Court.
- The Committee of Inspection has a number of duties and powers, which include advising or consulting with the liquidator on various matters.

## Types of creditors

There are two types of creditors:

- A secured creditor – they hold a charge (for example a mortgage) over part or all of the company's assets. The rights of the secured creditor are set out in the document called a Mortgage Debenture document or Deed of Registered Charge. They have the right to appoint a receiver if the company fails to meet its obligations under the debenture or charge and this right continues if the company has been liquidated.
- An unsecured creditor – They have only contractual rights and those collectively arising out of a liquidation. Unsecured creditors have a number of rights when a company is wound up. These rights include the right to:
  - Share in any available funds after costs of liquidation and priority payments and secured creditors have then settled.
  - Take part in choosing the liquidator in the creditors voluntary winding up.
  - Attend and vote at meetings of creditors on various matters including the fixing of the liquidator's remuneration.
  - Take part in the appointment and be a member of the Committee of Inspection.
  - Receive information about the liquidation of the company including the sale of its assets and the way in which the proceeds are distributed.

Unsecured creditors should attend all the meetings called by the liquidator because this is the best chance they have of finding out what is going on and of having their say. In limited circumstances, unsecured creditors (as well as secured creditors) can sue directors of the company for losses if the company continued trading while it was unable to pay its debts on time (when it was insolvent).

## BANKRUPTCY

### What is bankruptcy?

Bankruptcy is a legal process that gives immediate financial relief to people with financial problems by stopping legal actions against them by their creditors. It is a legal process that is controlled by law. It usually results in getting rid of most the person's debt and to those who cannot see their way out of a financial hurdle; this is often the best option to take.

Bankruptcy is the term used for individuals, rather than for businesses and companies. The term for businesses and companies is liquidation. The bankruptcy procedure is set up really with the purpose of giving the person with the problems a fresh start. It takes into account what that person owns and then these are split by a Court appointed person (the official assignee) and distributed amongst the creditors. If there are not sufficient assets to cover the creditors' debts, then the split is on a basis of percentage.

The law allows for both creditor and debtor initiation of bankruptcy.

### Consult a lawyer or an accountant

If your business is in danger of heading into problems, which could lead to the liquidation of your business, as well as the possibility of bankruptcy for you personally, then you should seek professional advice as soon as possible.

When lawyers are talking about bankruptcy, they are really meaning that there is a situation where the person is unable to pay their bills when those bills have become due. As already explained, the term bankruptcy is generally applied to non-business type situations where the business is a corporate structure, such as a company. A sole trader and also a partnership, however, can go into bankruptcy and therefore it is considered in a situation where the business 'goes under'.

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## **Why consider bankruptcy?**

Bankruptcy should only be looked at by a business owner in a situation where efforts have been made to keep the business floating and pay all creditors, but without success. It can mean that costs arising are compared to income coming in and the situation of the business, as well as the creditors, deteriorates. It is at that time that considering bankruptcy may be a more sensible option to pursue, rather than allow things to get worse.

At that point a business owner should contact their creditors and try to work out some sort of plan to make payment over a period to them. If this and another plan put in place to clear the debts of the business do not work, then talk to a lawyer about the necessity for putting the business into a bankrupt situation or liquidation.

While this process is not pleasant and it does require more costs and time in the sense of legal fees as well as court involvement, the final results may justify moving in this direction.

## **What bankruptcy will do**

By filing for bankruptcy the following situation will probably result for the person filing:

- Stops all further action from creditors and gives the person breathing space.
- Stops foreclosure actions on the person's home or action against their assets.
- Prevents repossession of their vehicles or other property where money is owed.
- Stops harassment from debt collection agencies.
- Allows the person to challenge the claims of creditors who perhaps are seeking to collect more than the debt owing.
- Finally discharges all liabilities belonging to the person and enables a fresh start. Bankruptcy places severe restrictions on the financial and personal independence of the debtor.

## **What bankruptcy won't do**

While bankruptcy will relieve the immediate distressed person of financial problems, it is not intended to cure all situations. For example, some of the things that bankruptcy will not resolve include the following:

- Discharge the rights of creditors who have proper security over the assets of the business or the person. That creditor will be entitled to take the asset because of the security held.
- May not discharge against some things the court decides should remain, such as child maintenance and alimony etc.
- Will not cover debts that are incurred by the bankrupt after filing for bankruptcy.
- Will not protect other people who are tied in with the bankrupt, such as those who have issued guarantees supporting the bankrupt.

## **Keeping honest**

If a person is looking at bankruptcy this should not be used as a means to get out of responsibilities and to defraud the creditors of their rightful payments. The court is not a stupid and toothless authority, so it is not a wise move to try and be dishonest when it comes to the process of bankruptcy.

The courts are very strong on penalising and imprisoning people who use the bankruptcy legislation for their own means, if the case is not a genuine one. The law is specific in that the courts can go back for certain periods and recover money or assets that have been diverted to other people, so as not to be included in the bankruptcy action.

If there is any fraud involved in some of these situations, then the person may be subject to criminal charges. The policy is that once bankruptcy papers are filed, the person should be honest and open about all affairs so that the matter can be tidied up to the advantage of the person, creditors and others.