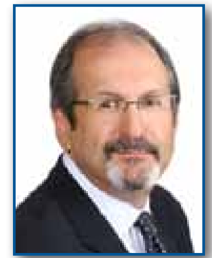
Member's Quarterly Summer 2023 Edition

Feature

What's Up? Insolvencies

Watch for the early warning signs



Philip Gennis
J.D., CIRP

MSI SPERGEL INC.

The Office of the Superintendent of Bankruptcy reported that the number of insolvencies filed by Canadian companies in 2022 was up 37.2 per cent compared with 2021 and the problem is getting worse, not better.

Here are some raw and sobering numbers:

- In 2022, there were 3,402 business insolvencies, up from 2,480 in 2021
- Business bankruptcies totalled 2,621 in 2022, up from 1,942
- Debt settlement proposals filed by businesses amounted to 781, up from 538 in 2021.

What's driving this?

Only about half of small and medium-sized businesses, according to the Canadian Federation of Independent Business (CFIB), have seen their sales return to pre-pandemic levels. For those who have seen a return to more regular business levels, they are struggling with high inflation, higher interest rates, labour shortages and supply chain challenges.

Many businesses borrowed money from a variety of sources during the pandemic. That included readily available cash from the federal government through the Canada Emergency Business Account. While most of those loans were interest-free, now they have to be repaid and many businesses of all sizes are having trouble keeping up with those payments.

There has been a little relief and some breathing room created when the repayment deadline was moved to Dec. 31, 2023. Even with the extension, many organizations still won't be able to increase their sales enough to meet that deadline. Many like the CFIB are pushing for another extension which could come as welcome relief to struggling enterprises.

What's next?

According to the Office of the Superintendent of Bankruptcy, the companies most at risk are in the accommodations, construction and food services industries. This is not surprising given the downturn in the travel and tourism industries during long periods of lockdowns and limited openings.

It may get worse before it gets better. The Chair of the Canadian Association of Insolvency and Restructuring Professionals, Jean-Daniel Breton, said in a statement that "We expect to see additional pressure on debtors and a subsequent increase in the number of business insolvencies as higher borrowing and input costs impact businesses still struggling to recover from the pandemic."

In one note of optimism, Mr. Breton said that the increase in insolvency filings wasn't necessarily a bad thing. Sometimes this meant that businesses were reorganizing themselves to prepare for the future. This is a proactive measure that means these companies are taking proactive measures to put themselves on a more stable financial footing.

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Feature continued

On a more hands-on level, there are a number of things which owner-operated businesses should know. The first thing that any business should do is recognize the warning signs of business distress long before there are discussions of insolvency or bankruptcy. If you know the speed bumps that lie ahead, you may be able to avoid some of them. Others may be unavoidable, like a recession or market collapse or heaven forbid another worldwide pandemic. If you know the risks and plan for them, you have a much better chance of landing your business on the right side of the ledger once the danger passes.

Here are some early warning signs that you should pay attention to. They should be reviewed and analysed periodically so that you know the true health of your business and the risks on the road ahead.

- Borrowing is extended to the limits negotiated with bankers;
- Major discrepancies exist between internally prepared and audited financial statements;
- Persistent operating losses;
- Significant variances between actual and projected results;
- Excessive build-up of receivables and/or inventory, both of which are turning over more slowly from year to year as compared against industry standards;
- Build-up of trade payables and government liabilities;
- Lack of useful and timely financial information;
- Lack of budgeting and cash flow projection;
- Unrealistic annual projections and cash flow forecasting;
- Lack of meaningful follow-up on negative variances from budget;
- Overambitious expansion and/or acquisitions;
- Inadequate capitalization;
- Problems with technology;
- High concentration of sales to a small number of customers;
- High fixed costs in a business with unpredictable results;
- Increase in competition;
- Little, if any, delegation of authority;
- Aging ownership without an established succession plan;
- Lack of a clear business plan;
- Turnover of key personnel.

Having some or all of these indicators does not mean you're in trouble-yet. But they are signposts that suggest your business is in trouble, at least by some measurements. They should all be treated seriously and with urgency if you don't want to find yourself in much hotter water.

Peter Drucker, the business and management guru, once said: "Trying to predict the future is like trying to drive down a country road at night with no lights while looking out the back window." That is true, but it is easy to predict where we're going if we pay attention to the signs along the way.

Philip Gennis is a Licensed Insolvency Trustee with msi Spergel Inc. and can be reached via email at pgennis@spergel.ca.

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