Insolvencies Are Well-Above Pre-COVID Levels and Rising

What Precautions Should You Take?

In my December 2022 article, I predicted that when insolvencies started to surge in the Australian economy, the worst casualties would likely be in construction.[1] It's taken a while for my predicted post-COVID day of reckoning to arrive in Australia. But it is here.

By 30 June 2024, ASIC expects the number of companies entering external administration will exceed 10,000 – a level not seen since FY13. And, currently, construction companies make up the largest slice of those failures.[2]

For the nine-month period from 1 July 2023 to 31 March 2024, ASIC tracked 7,742 companies entering external administration – a 36.2% increase on the previous corresponding nine-month period.[3] According to ASIC, "construction (2,142), and accommodation and food services industries (1,174) represented the greatest number of company failures, accounting for nearly 27.7% and 15.2% respectively".[4]

The Honeymoon Is Over

After years of local businesses being propped up by stimulus and support, the true impacts of the pandemic are finally starting to emerge. The ATO has had to start enforcement proceedings to claw back the tax arrears that were allowed to blow out to protect companies that otherwise would not have survived the COVID-19 lockdowns. Government support is long gone and previously supportive and understanding finance partners are taking a sterner line.

For any business with – or dependent on entities with – weak fundamentals, the writing is on the wall.

Not the Time to Panic

Clearly, the current market conditions are presenting challenges for businesses. The rash of financial and operating hardship is precipitating a return to active restructuring – on and offshore – and above average levels of insolvency. Small businesses in particular are experiencing huge failure rates in the first 12 months.

In this environment, it's easy for business owners and boards to catastrophise. As the media panic continually reminds us, the economy is being buffeted by increases in the cost of living, interest rates and inflation. Business are battling a lumpy supply chain, labour shortages, wage pressure and highly competitive pricing. We can't rule out further adverse impacts on the local economy given the instability of global markets - with the ripple effects to manifest in ways yet to become fully apparent.

And yet, a lot of money is continuing to be made and recycled back through the economy. The financial markets have the capacity to help sound companies survive. Although the latest GDP data appeared soft, it revealed a substantial upgrade to consumer spending. Australia is continuing to grow – a state of play that results in natural insolvencies.

There is no need for companies to panic – but they should take sensible precautions.

The Adjustment We Had to Have

Finally, it's worth seeing the current situation for what it is: a well overdue and necessary adjustment. The insolvency news appears alarming, but it's actually a sign that natural selection is back in play in Australia's economy.

> *For sound companies with sensible management, this is good news.*

In the coming months, the people driving costs to the bottom will exit the market, enabling a period where others can reset and reassess. Those who survive will enjoy a new form of normality, where work can be priced at decent levels and solid businesses will make a dollar again.

This is not going to happen any time soon. It may be a number of years before the market returns to 'normal' and insolvencies come back to historic averages. But those prepared to get their businesses in order, plan for the worst and reduce risk have a good opportunity to survive the reset and create value in a more promising commercial environment.

Hope for the best. Plan for the worst.

Companies need to understand where they are vulnerable and prepare for emerging challenges. We recommend:

Identifying critical points of failure – Smaller suppliers often rely heavily on a few key clients for the bulk of their revenue. If a major customer goes bankrupt, the resulting cash flow issues can push otherwise sound companies into insolvency themselves. A key counterparty insolvency event creates a domino effect, where the failure of one link can cascade through the entire supply network. By proactively identifying likely points of failure, businesses can assess risk and develop contingency plans. This may be the catalyst for diversifying a customer base or upgrading risk mitigation strategies to ensure continuity and stability.

Taking steps to support early intervention – This is not the time for heads to be buried in the sand. Act on warning signs and get expert advice early to understand all the options and extend the runway. Australia has strong safe harbour legislation that affords protection while navigating a restructuring plan. But government will only throw companies a lifeline if they present in time for a rescue. Increased emphasis on early intervention goes a long way to prevent insolvency appointments.

Getting advice even if you're not worried – It's worth having more than one fall-back plan. Talk through 'what if' scenarios with advisors and understand how to respond should unexpectedly negative situations arise. This type of preparation is not only important to maintain operational stability during periods of volatility, but it also gives financiers confidence around organisational resilience.

HOW FTI CONSULTING CAN HELP

Our experienced team is skilled at engineering and executing formal and informal solutions to maximise value. Whether it's providing an in-depth turnaround plan to drive value in a restructure, or supporting clients in more distressed situations on how to move forward with a sale or exiting the business.

Our senior leaders and qualified liquidators can accept formal appointments across Australia and can swiftly mobilise a team on the ground to respond to the urgent needs of a client. They combine an unprecedented depth of knowledge and experience across regions, geographies and technical capabilities – tailored to the situations and challenges facing a business. Our primary focus is always to provide the best outcome possible for stakeholders.

We are also accustomed to dealing with the practical issues that are the difference between success and disaster.

[1] John Park, "Inflation Is Raging, Rates Are Rising and Markets Are Reeling. Where Are All the Insolvencies?", FTI Consulting, (12 December 2022), <https://www.fticonsulting.com/insights/articles/inflation-raging-rates-rising-markets-reeling-insolvencies>.
[2] "ASIC insolvency data shows increase in companies failing", Australian Securities & Investments Commission, (18 April 2024), <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2024-releases/24-077mr-asic-insolvency-data-shows-increase-in-companies-failing/>.
[3] Ibid.
[4] Ibid.

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