When Businesses Fail

By Jerry Merola

Sometimes, no matter how hard one tries, success is not always forthcoming. Statistics support the likelihood that more new businesses within an industry will fail rather than succeed. The reasons for such failure are as diverse as the universe, but the more common culprits include insufficiently trained management, erosion of target market, arrival of intense competition, under-capitalization, and perhaps missing the market altogether. At times, death can be slow, with revenues from operations consistently trailing expenses. Other times it's fast, as learned by many business owners after the terrorist attacks of 2001 altered the way consumers travel and spend their money. How you fail becomes just as important as how you succeed. If you do a little digging, you'll find that almost all successful entrepreneurs in the headlines today have actually failed in other business attempts - multiple times!. How then did they get back on their feet? This column looks to address this very issue.

Failure: The Final Frontier

When you're sure you've exhausted all options for debt restructuring, raising of fresh partner capital, and remarketing of the core business, it's time to plan the wind down of the operation. If you can swing it, discuss a payment plan with current creditors. Let them know where you stand and what you're financial capabilities are. Avoiding creditors will most certainly result in a hostile relationship going forward. If bankruptcy proves to be your only real option, again consider the results from your actions. There is a huge difference between declaring bankruptcy with all creditors paid (eventually) versus leaving all creditors holding the bag. While it might not be the first thing on your mind right now, you may choose to open a new business someday (or be a partner in a new venture) and your bankruptcy status will be examined carefully (and negatively) by future lenders. Remember the old adage, "what goes around comes around". Unless you headed for an uncharted island, take some time to discuss your options with a qualified bankruptcy attorney.

Choosing Your Poison

Let's say that you've decided to file for bankruptcy under the standards adopted under Chapter 7 of the Bankruptcy Code (dissolution of business entity). The court will assign a trustee to the matter to wind down operations and coordinate the dissolution of assets. While you may not have had the success you deserved when you were operating the business, you still have a chance to follow through on the back end, particularly with the liquidation of assets. Many times I find that the trustees are not readily familiar with the assets commonly used in the amusement and entertainment industries, and therefore have a tendency to "dump" the goods below their realistic market value. The end result is that the lienholder of those assets, probably your bank, is going to come up short in settling out your loan accounts, resulting in a "charge off" of the unpaid balance. This bodes badly on you. I have personally observed situations whereby the bankruptcy court approved the liquidation of a company's assets for 10 or 20 cents on a dollar when you or I could have reasonably obtained 50 to 60 cents. Every bankruptcy has a "magnitude", that is, how much the creditor portfolio actually loses compared to the dollar value of the claims. By keeping the magnitude of the loss low, you might be able to file bankruptcy and actually make your creditors whole. A "bankruptcy with creditors paid" notation on your credit report is viewed dramatically better than one that says "unpaid". What is says is that you stood behind your commitment. Maybe your business concept was half-baked or perhaps the operation was financed on a shoe-string, but whatever the reason, you took the responsibility for the loss.

Accounting For Assets

My firm is commonly contacted by lenders to perform pre- and post- bankruptcy examinations of amusement and entertainment assets to determine current market values, condition, and locations of liened assets. What we see going in can be significantly different than what we see going out. What happened to the plasma tv's? Where are the computers? Who ran off with the point-of-sale system? Naturally, removal of assets is in direct violation of the bankruptcy code, yet it happens everyday. Who loses? You do. As mentioned earlier, the magnitude of the losses will eventually have its way with you. If you intend to do the right thing, the first order of business is to tighten up the operation during the wind down period. Treat your facility like Fort Knox. Nothing comes in or out without a very solid reason. The more cooperative you are with lenders and financiers, the greater likelihood that they'll listen to your input. So instead of sitting back and watching your assets change hands for 10% of their original value, you might be able to steer your financial backers to the point of narrowing their losses. After all, lenders don't forget.

Taking Care of Business

Business dissolution can take a huge toll on your personal state of mind. No one likes to failure, particularly when there's money involved. A bankruptcy or business wind up will most certainly have a financial impact on you and your family. But it will also have a devastating effect on your employees, many of whom might have been at your side since inception. Unfortunately, no matter how you slice it, their loyalty has been rewarded with an empty pay envelope. These same individuals have mortgages, car loans, rent, and all the other living expenses that you have. The difference is, however, that you saw it coming first. Most of the time, they're the last to know. Being the last to know means there's no time to make alternate employment arrangements or prepare for the possibility of a lengthy unemployment period. It's important to do the right thing for your staff as well. That means making sure that they've been paid, even if that means you won't be. Again, what goes around comes around. I could fill up three more columns in this magazine with the names of individuals that others "will never work for again", brought about predominantly by broken promises of payment. When it's all said and done, all any of us have is our integrity and the respect of others - both of which can only remain in place if the right thing is done.

Looking Over The Horizon

Failure is not so much about what you did wrong as it is about what you've learned. If you ask around, I think you'll find that many of your friends, business associates, and acquaintenances have opened- and closed - businesses at some point. Having watched the failure of businesses from the financial services side of the fence, the "the way you fail" question is significantly more important than "why you fail". So, if someday the tide turns and your business operation comes to an end, I hope you'll give some thought to the manner in which the process unfolds. After all, if a cat has nine lives, each of us must have at least three.

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