



## How to Avoid Bankruptcy and Build a Strong, Successful Business

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By most measures the economy is strong. Unemployment is low. The stock market is roaring. Gross domestic product is rising. Under these circumstances, bankruptcy is on few people's minds.

Corporate bankruptcy tends to be cyclical, and bankruptcy filings trend up and down along with the direction of the macro economy. The last big surge in corporate bankruptcy filings came in the wake of last decade's financial crisis (and closer to home here in Michigan, the automotive crisis) and "Great Recession."

But while trends in bankruptcy are macro in nature, if you run a business that's struggling it doesn't really matter what is happening in the broader economy—you're feeling the pain in a very micro sense and need to act quickly and strategically to stop the bleeding to have a chance to avoid bankruptcy.

This article addresses things businesses should know about bankruptcy, and how to stay out of it. Let's start by discussing common mistakes that businesses make that get them into trouble.

### **What Leads to Bankruptcy?**

Three of the biggest mistakes that can lead to bankruptcy include:

**1. Over-Extension.** Growth requires investment, but many companies—even otherwise healthy ones—find themselves on the brink of insolvency because they take on too much debt. If they can't service or refinance the debt, they default and are faced with few options other than trying to reorganize through a Chapter 11 bankruptcy filing.

**2. Lack of Bookkeeping/Recordkeeping.** When businesses don't have a good handle on their books, they often run into difficulty. A business with sloppy bookkeeping is typically surprised that its performance isn't what it expected—revenue is lower and expenses are higher than it thought. By the time the problem is diagnosed, it's often

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too late to fix it.

**3. Over-Optimism.** An unrealistically rosy outlook gets businesses into trouble. When things are seemingly good, businesses invest in new projects and new people. Their expenses increase in anticipation of new revenue, but if work they expected to come in gets delayed or cancelled, then they're left scrambling—or worse, end up in bankruptcy.

### **How to Avoid Bankruptcy?**

Avoiding bankruptcy requires discipline, rigor, and smarts—in other words, it requires good fundamental business practices. Here are some of the things businesses should do to steer clear of bankruptcy:

**1. Be Conservative.** Don't assume every customer is going to pay. Don't assume every customer is going to stay. Budget for a reasonable case scenario, not a best case scenario. Be optimistic about the future, but not overly so. It's often assumed that the world's top entrepreneurs, such as Richard Branson and Jeff Bezos, are swashbuckling risk takers. While they do take risk, it is always calculated and done in a way that protects against the downside. Branson, for example, has experienced many failures as part of his Virgin conglomerate portfolio, but none so big that it has knocked him out of the game.

**2. Have a Written Business Plan.** Most businesses start very small, and their business "plans" exist solely in the heads of their founders. Unfortunately, as businesses grow, often there is still no written business plan, despite the acute need for one.

Every business should have a written plan that describes strategies and tactics related to things like sales, operating budgets, capital expenses, cash flow, input costs, performance objectives, and a means to track performance.

Having a plan allows everyone in a business to understand the big picture and direct their actions toward achieving business objectives. The nonexistence of a plan is what derails businesses—in fact, without a plan no one knows what track they are supposed to be on in the first place.

**3. Prioritize Debt Repayment.** As previously discussed, businesses get into trouble when they over-extend. The best way to avoid over-extending is not to borrow in the first place. The next best way is to ensure that you're prioritizing debt repayment. When evaluating your debt repayment strategy, prioritize secured debt (such as a loan secured by a piece of equipment) and high interest debt first. If you can, avoid unsecured debt (such as credit card debt) altogether. In any loan or financing arrangement, negotiate for the best terms possible, and make sure to get it in writing.

**4. Eliminate Unnecessary Expenses.** Take a look at your bank and credit card statements on a monthly basis. Are you incurring unnecessary expenditures? Are there recurring charges, such as for software that you never use, that you can eliminate?



**5. Stay in Touch with Lenders.** Stay in close communication with your lenders. Be responsive to their requests for information. If you're having trouble in your business, and you're late on a debt payment, or miss one altogether, it will raise red flags with your lenders. Failing to respond to your lenders when they inquire as to why you were late, or missed a payment, will raise even more. On the other hand, if you're in trouble and approach your lenders with a plan, there's a chance that you'll be able to negotiate a payment extension, or restructure your loan terms altogether.

**6. Review Insurance Policies.** Insurance is a major expense for most businesses. From health, to disability, to property and casualty, premiums tend to go up every year and suck cash flow away from more productive uses. Talk to your insurance agent. Consider what options are available. For instance, by purchasing a policy with a higher deductible, you can often decrease your monthly premium significantly.

There are also many different life insurance options to consider. Term insurance is cheaper, but a whole life policy offers you the option to borrow against its cash value. Again, consult with your agent to determine your needs, and the best way to meet them based on where you're at in life.

**7. Craft a Retirement Strategy.** Just as you should have a written business plan, you should have a written plan for retirement as well. Start thinking about who will succeed you. For example, if you have more than one child involved in the business, who is better equipped to handle the job? Regardless, have you thought through how to address the near inevitably of strife and hurt feelings resulting from your decision? Consider how your succession plan will be funded. There are lots of options available, such as borrowing, transferring property, or a payment structure, to implement a succession plan. Whatever you do, make sure to consult with professionals to address legal, tax, and other issues implicated by your ultimate plan of action.

**8. Take Advantage of Tax Reform.** This year's tax reform offers businesses the opportunity to use extra cash from tax savings to pay down debt and make strategic investments.

Running a successful business requires constant vigilance. Take stock of your situation frequently. Have frank conversations with your team about your expectations in light of your goals. Make hard decisions, such as making a management change. Take time off to clear your head and replenish your energy. Stay abreast of the latest developments and best practices in your industry. Develop relationships with experienced advisors, such as a lawyer, accountant, and banker, who can guide you through tough decisions and strategic initiatives. Do these things and you'll not only be better positioned to avoid bankruptcy, you'll be setting yourself up for success.

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