



*Kingsway
Financial
Assessments*

Call +61-2-8305-0600

20% of all insolvencies are in the construction sector : ASIC

Each week in Australia over 200 companies enter into some form of external administration. In July 2009 there were 876 such companies, an upward trend since April this year.

According to the latest ASIC data shown in Figure 1, in July 2009 New South Wales experienced the highest number of companies entering external administration (363) almost twice as many as Victoria (203) and Queensland (196).

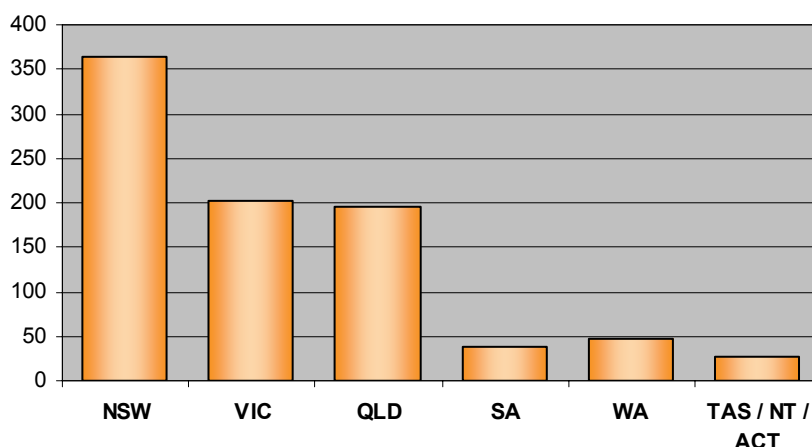
In addition to the general downturn in construction activity, the high number of insolvencies in NSW is also likely to be a reflection of a higher incidence of wind up notices instigated by WorkCover in NSW.

While clients who use Kingsway's service show a negligible or zero rates of insolvency amongst the contractors they select, the rate of insolvency in the construction sector is disproportionately high.

A recent report by ASIC shows that the construction industry was the single greatest contributor to the number of external administrations in the 3 years analysed, with the construction industry making up 20% of all insolvencies.

ASIC cited the following as the most common reasons for

Figure 1. Companies entering external administration, totals by State, July 2009 (ASIC)



Insolvency, i) poor strategic management, ii) inadequate cash flow and iii) trading losses.

According to ASIC, 82% of the companies that went into external administration had less than 20 employees, 87% had assets of less than \$100,000 and in 96% of cases, unsecured creditors received less than 10c in the dollar.

Source: ASIC Report 132 June 2008.

Commenting on these findings Kingsway Director, Robert Jochelson noted an emerging trend in 2009 of overdue monies owed to the Australian Taxation Office (ATO) for Income Tax, Withholding Tax, and GST obligations by construction firms and sub-contractors.

Mr Jochelson also stated that, "In many cases construction companies have advanced loans to directors or other related parties such as development companies. These loans are frequently not properly documented and do not undergo the usual credit checking required,

making them more difficult to recover in the event of an insolvency."

Steer clear of builders at risk

Financial assessment of contractors prior to the award of a contract remains an essential risk management tool for any organisation calling for tenders.

Kingsway Financial Assessments has designed a range of credit and financial reports designed specifically to steer organisations clear of builders at risk of failure.

The specialised reports identify early warning signs of liquidity problems experienced by builders and other specialist contractors.

kingswayassessments.com.au



**Kingsway
Financial
Assessments**

Call +61-2-8305-0600

Working capital problems experienced by 24% of building contractors

In the past 12 months the proportion of contractors assessed that were rated as 'unsatisfactory' for failing to meet the minimum financial criteria has reached 24%, a 5% increase from previous years.

This data is derived from analysis of the outcomes of thousands of assessments performed by Kingsway Financial Assessments Pty Ltd.

The most frequent reason for contractors being rated as unsatisfactory was a shortfall in Current Assets over Current Liabilities resulting in negative Working Capital.

This shortage of liquidity results in a slowing of cash flow along the contracting chain and creates payment problems for subcontractors. Likewise it puts clients at risk of not having their contracts completed on time.

The high incidence of 'builders in distress' could be a result of a number of factors.

'Buying work', a phenomena that has been around for some time, has caused many builders to come unstuck. Essentially, in buying work, builders under quote to keep their companies fully operational.

Poor estimating and purchasing procedures have resulted in builders being unable to procure the labour and materials required to complete jobs profitably after entering fixed-price contracts.

Cash flow difficulties rank highly as a precipitating factor and tend to occur towards project

completion dates. It is at this stage that subcontractors begin to experience delays in progress payments, receive only part payments and encounter disputed claims from builders.

The sham finally comes to an end when major suppliers, with too much at stake, suspect severe liquidity problems. A wind-up notice is issued and the court appoints an administrator.

In some cases, building companies place themselves into voluntary external administration to avoid insolvent trading, but unfortunately this is not always the case. Some builders continue to trade in the hope that their cash flow will improve with the profitability of the next job. However, with high levels of competition in the marketplace today, margins remain extremely low and the problem is exacerbated further.

Another contributing factor is insufficient attention, by small and medium sized builders, to the planning and implementation of project and financial management controls. In effect, builders act as project managers who coordinate the work of subcontractors.

Over 95% of the value of the labour spent on site can be performed by subcontractors. It is important to remember that all principals' funds are paid directly to the builder on whom the obligation falls to pay others for the work done and for materials supplied. Inadequate financial controls frequently result in a shortfall of funds down the payment chain.

Unfortunately, in the event of a dispute between the principal and the head contractor (often due to poor project management) subcontractors find they have little or no security over the monies owed to them. In such cases, the builder's under capitalisation may lead to eventual collapse following desperate attempts to continue trading.

The increased use of the Building and Construction Security of Payments Act in NSW has been of some benefit in speeding up the cash flow on projects, however more work is required to refine the process.

‘Keep Your Project
on track’



kingswayassessments.com.au