



Talking Law

Episode 140 – Managing Supply Chains and Contracts in a Downturn

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Transcript

Joanna:

Hi, it's Joanna Oakey here. And welcome back to talking law, a podcast proudly brought to you by our commercial legal practice Aspect Legal now in this episode, we speak to our very own mark Gardner, all about what business owners and their teams should be looking out for when managing suppliers and supply contracts. In a downturn, we drill into a few risk factors and warning signs to look out for in this area, how to deal with customers with signs of insolvency, and much more. These are all critical things to understand right now volatile times often expose new and enhance risks that you should be preparing for the sooner the better right? So without further ado, here's our discussion with Mark.

Joanna:

Mark. Huge welcome to you on the show today.

Mark:

It's a pleasure to be here, Jo. Thanks for having me.

Joanna:

It's always a pleasure to have you, Mark. Now such an important topic, topical, obviously right now how to manage a business in a downturn, obviously, so topical at the moment, because we see a lot of concern in the business market right at the moment. And you know, and a lot of signs of distress in businesses. So I think this is super critical for business owners to be aware of not just from their own business perspective, but to be aware of what might be happening to customers and suppliers as well.

Mark:

That's right. We're really in some uncertain times.

Joanna:

We absolutely are. Absolutely. And I guess just giving it an overview, what what are some of the key areas that you think businesses should be thinking about, in preparing themselves for this more difficult environment that we're heading into?

Mark:

Yeah, look, I think a business owner needs to really think about what happens in a downturn and how it might impact their business and to think about things like how will our customers behave? How will our competitors react? What are our strengths? What are our challenges? Are there opportunities here? And are there any things that we should be concerned about with suppliers? And so how do we how do we look at all this going forward? It's like, well, I guess a manager these from time to time to try to step back from the day to day and just spend a little bit of time thinking about managing it in an economic environment that most managers haven't seen. We had our last recession in the early 90s, so close to 30 years ago, and people haven't had to deal with any of these issues.

Joanna:

That's a good point. It really is a good point. And so So I guess starting with that thought process, how will customers behave? What should businesses be looking out for? What are some of the risk factors? What are some of the warning signs?

Mark:

The key warning sign is payment. Are your customers starting to pay late? Are they starting to reduce their order quantities? Are they starting to slow down their normal business cycle? And then there can be some subtle changes? Is there a high staff turnover happening in their business? Are you dealing with new people all the time? Are you with fewer people in on a customer side? and it's just a matter of being aware that the customer may be experiencing some distress.

Joanna:

And one of the things that I finally often see with businesses, that customers that might be suffering distress for our clients or customers is identifying part payments of invoices, payments in round numbers, you know, that there's sort of a little bit of a red flag that there's that there's things going on there trying to manage cash flow in the business tightly, but not being able to meet payments as they do.

Joanna:

And so what are some of the things that our clients then can be thinking about doing if they identify some customers where they feel there might be some risk as to, you know, future stability solvency?

Mark:

I think the first and foremost is to understand your exposure and how important is this customer to you and start to think long and hard about whether or not you want to continue to supply the customer as a starting point. Do I make a situation worse by staying in there and helping out the customer or do I cut my loss says and say, Well, I have to, I have to stop supplying. And that can be a really difficult conversation to have, and one that I think most business owners will try to avoid. But I think the key is to not expose your own business to the failings of a customer. And then I think you need to look at the contractual relationship that you have with the customer. What is your security for payment? Are there guarantees in place? And do you have, for example, that PPSR registration.

Joanna:

Such a good point that you make Mark, I think now is the perfect time for businesses to be assessing, you know, what clients they have on credit, whether those credit terms that they're providing are appropriate on an individual and on a group basis, you know, right now, so they might want to bring in their credit terms, either across the board or for individual clients, and whether or not they're utilizing properly some of these other opportunities, such as the personal property securities register? Absolutely. Because I find actually, there's so many SMEs who just aren't on top of that, maybe you've heard a bit about it, but just aren't. Don't don't have any of their clients registered.

Mark:

That's right. And I think typically PPSR sort of contract terms are complicated. And they're complicated, because they're essentially a term of lawyers have put them together to try to protect everybody. If a customer or supplier, for example, reading a PPSR set of terms, I think the eyes glaze over by about the second paragraph. Sometimes minder, as well, I have to say, I wasn't gonna put my hand up and say this, I think, yeah, that's right. But essentially, by registering their security on the on the register, it moves a person for being an unsecured creditor to a secured creditor. So it improves the position in the event of a liquidation of a customer. So that's important, it really is important. So but perhaps is even a more fundamental step. And that's to make sure you have a contract in place, that the contracts haven't expired, that the terms are still binding and appropriate. That hasn't been a change in, in the company that you're dealing with. And you still got a contract with the old company, those kinds of fundamentals, business health checks, which sell often get overlooked, because you're busy. But in matter, again, that's stepping back, assessing the position and working out where do we stand with, with our customers, with our suppliers with our staff? And how do we manage this this uncertain period?

Joanna:

Yeah, yeah, absolutely. And, I guess one other point is that even though you have have been paid by your customers, doesn't mean that there's not a risk that that could be clawed back, maybe talk our listeners through how that can potentially work.

Mark:

Okay. Perhaps I'll start with an example, just to frighten our listeners. So imagine that you've been dealing with a customer, you're aware that they're struggling financially, you've extended your terms a couple of times, you've had you've had some conversations with them, but they've paid you late, perhaps underpaid you, but then sadly, they go into liquidation. And you think that's really sad, but you're relieved because at least you got paid? And then you get a letter from a liquidator, which says, You have received an unfair preference and all that money you've received from this customer you have to give to the liquidator. That's generally not a good day.

Joanna:

No, absolutely. I just want to add to this, like this happens all the time. You know, so don't think that this is you know, something that wouldn't happen to you. It is a regular event. It happens all the time.

Mark:

It's the what's called a relating back period. So, payments that are made within six months of a liquidation are subject to examination by a liquidator to determine if the party that receives the payment has received what's called an unfair preference. Because what the liquidator is doing is liquidators job, among other things, is to try to make it fair for all the creditors of a company that's gone into liquidation. And so if one company has been paid, and others not, the law says well that can be an unfair preference. So the money goes back into the pool by the liquidator and is used to try to treat all the creditors equally. Now that's good if you haven't been paid and you might get some cents in the dollar. It's really bad if you have been paid and have to give it back back. And as a supplier to the customer, if you have reasonable grounds for suspecting that the customer is in financial distress, that would mean that it would be an unfair preference claim that will be made successfully against you. So if you've had discussions with a with a with a customer about their payment issues, that can be of itself enough to have you put on notice that the customer is in financial distress and you could be subjected to to a an unfair preference claim from a liquidator.

Joanna:

And I think it's such good timely information that we passing out here, it's such good reminders. Because there's two components, I think Mark of what you're talking about here. First is, is the way that you manage your discussions with in relation to your your customers might be having difficulties in payment. So we'll talk about that in a moment. The second is in dealing with any sort of any communication you get from a liquidator where there is an attempt to the clawback for preferential payment. So that on the second point, I think the very first thing to say is, don't just pay money back, come and get legal advice quickly, because there's a way to deal with it. You know, so I think that's the market absolutely to run and get legal advice very quickly,

Mark:

Can I add a second point there, don't ignore the letter. Don't ignore the letter. I've seen that happen. And then you get many months down the track. The money that has been received from the customer has long gone. And suddenly you're looking at having to pay an amount of money. But as you say, getting legal advice is absolutely critical. There are defenses to an unfair preference claim.

Mark:

They can be quite technical, and they can involve quite some lengthy analysis of the facts and circumstances around the supply arrangements in the payments. So getting legal advice is really important.

Joanna:

And getting legal advice earlier in the piece. Might be the real key they hear though, Mark?

Mark:

Absolutely. And hence, don't ignore the letter.

Joanna:

Yeah, no, but I mean, even before that, Mark, even when if your if your customer, you know, if you become aware of your customer having difficulties in payment of invoices, I think at that point, just make sense to you know, give your legal team a call and make sure you understand, you know, anything that you should be aware of, in how you're conducting those discussions about payment.

Mark:

That's right. And put you on notice as well, that could be an issue, it's this client is really in trouble, that you may have a client, so you may not want to spend all that money you've received.

Joanna:

Don't spend all the money you've received. That's the last tip don't spend all the money. What else? Are there any sort of other pointers that businesses should be thinking for about managing a downturn?

Mark:

I think I said initially, you know, how will our customers behave? So we're talking about that? How will our How will our suppliers behave? So are there issues with supply? The suppliers that you've got putting shortening their credit terms, making life more difficult? So, you know, just think about that in terms of you have your business operations and look at your contracts as well? What happens if your supplier becomes insolvent? What options do you have? Where else can you go for the key components of what you're selling? If your suppliers aren't there? So the I always, always give that some thought I love

Joanna:

that building, you know, backup a backup be backup see as well, you know, and I think if COVID showed us anything it was, you know, it showed us an exposure to supply chain that perhaps had just not been so apparent beforehand, you know, so that's right,

Mark:

I think we'd all just assumed that globalization was here to stay and was unshakeable. And yeah, you place an order and it comes no matter what and you know, from places we knew not where and then we realized that you know, sometimes, you know, key components come from overseas and the chips not there or the containers aren't available and suddenly everyone's got the lights.

Joanna:

Yeah, all the all the manufacturing plants will shut down for a while but anyway, he's hoping that doesn't happen, as well. It's right, that as well. And so So we'll talked about your relationships with your customers, we've talked about your relationships with with your suppliers. Are there any other business areas, I guess, that we should be thinking about?

Mark:

I think there's a general sort of business management focus that can come into play at this time. And that is to look at your own business operations. So, you know, examine your product or service lines, you know, which are the profitable ones, where should the focus be? Now? What are your costs of doing business and each of your divisions perhaps? And, you know, if we're anticipating that business might downturn, what's the cash collection? process you have in place? What's your cash position? What's your cash flow forecasting? And do we do you need to start looking at cost control now? Because the time to look at cost control is when you start to anticipate a downturn, not after you've your finance guys walked into your office and said, We're running out of cash?

Joanna:

And then we got to go give some money back to that customer at a preferential payment globe?

Mark:

And then things like, are your staffing levels appropriate? Are you over staffed in some areas, which you kind of known about for some time, but everything's fine. So you don't need to? Now it might be time to look at getting your headcount right and right sizing your how you go about it. And then of course, particularly these days with with people working from home so much, is your office the right size? D G needed such a large floor plan? Can you look at sharing options? Can you sublease, can you license some space? Can you share space with somebody else, think about cost controls before you need to it would be probably my number one rule of business.

Joanna:

Love it. And I guess the other area as well is then to take the opportunity to look at your employees and your leave balances.

Mark:

Leave is important. I've seen several costs a number of clients who've come to me and said I've got enormous amount of staff leaf building up, what can we do about it, because it's not so much a cash flow issue. But it's certainly a liability issue on the balance sheet, staff leave accruals and just add up, you should consider whether you should try to get that leave accrual balance down and encouraging staff to take leave. Most modern awards allow a direction from an employer to an employee to take leave. And if you're not covered by modern award, you might be covered by an enterprise agreement, which has a similar provision, or maybe your employment agreements do as well, you should look toward the to the requirements of that. And that is you can direct staff to take leave, so long as their leave balance doesn't fall below six weeks, they're allowed to have up to six weeks leave accrued. And you can direct to a leave to be taken if you give between eight- and 12-weeks' notice.

Mark:

So, think generally about pushing down that accrual? And then also look at your shutdown. I mean, making sure that you appropriately staff who are shut down period we're coming up, it seems very quickly toward Christmas. Yeah, what staff do you need on deck between that Christmas New Year period and early January, when it's traditionally quieter? You know, can you get that staff leave balance down at that point,

Joanna:

Such a good point, because you know, we have many clients that we work with all moving into exit. And it can be shocking for them at the point of exit to suddenly realize they've got this whole bank of liability sitting in their books and you know, that has to be dealt with at sale, whether it's adjusting to the purchaser, or you know, paying out the staff. But it must be dealt with,

Mark:

I think it comes as a real surprise to business owners that their sale price of the business is going to be impacted because their staff haven't taken leave. And I know Joe, you're you're focused on assisting businesses to exit the key is to think about the exit a long time before you want to exit and managing staff leave is just one of those things. It's so easy to overlook. So easy to overlook because it just sits there you the accounting team may say the balance is getting a bit high and you go Yeah, okay, but it's not really costing me any money. So sitting there and sort of find those paper liabilities, you know, it's not really there until you want to sell and then suddenly it's coming out of your pocket.

Joanna:

Yeah, absolutely. Or, you know, you have a number of staff leaving and at that point, you know, it's something that you have to pay out then so anyway.

Mark:

Then it becomes a cash it. That's right.

Joanna:

Well, look, Mark, I just wanted to say a huge thank you for coming on to the show today. Obviously, there's so many things that you've talked about that are just great advice for businesses. But of course, it's also about having, you know, a wise person to turn to with a steady head who can help you navigate that course. And look, thank you so much for giving us that wealth of information that I think as I said before, such a timely, such a timely reminder for us to be looking at what we can all do from a business perspective, you know, in a downturn or anticipating that we may be entering them

Mark:

pleasure, Joe. I'm glad, like share this wealth of information that I've accumulated over to far too many years.

Joanna:

Great. Thanks, Mark.

Joanna:

Well, that's it for this episode of Talking Law. We hope you found this episode useful and insightful. And if you'd like more information about this topic, then head over to our website at talkinglaw.com.au where you'll be able to download a transcript of this episode, as well as any contact details and additional information that we refer to. And if you'd like to get in contact with our guest today in the services they offer, you can go ahead and check out our show notes for those details. And of course, if you're interested to talk to any of our lawyers about anything relating to this topic, then just head over to our website at www.aspectlegal.com.au where you can book immediately a free 15-minute discussion with our Legal Eagles at any time that works for you. Of course, there's also a booking form in our show notes as well.

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