Insolvency Statue Lang Martin

# The word “Insolvency”

An enterprise is insolvent if it is not able to meet its payment obligation on time. These include credits, salaries for employees, payments of loan installments and interests as well as rent and leasing payments. In other words, the enterprise is no longer liquid.

Not only enterprises that had bad conditions from the beginning have to face these problems. It might also happen to companies that had a good start and wanted to expand. Such plans could also lead to a liquidity shortage.

A lack in liquidity does not necessarily lead to bankruptcy.

# Reasons for insolvency

The customers, the suppliers, the political environment and the weather, these are not the major reasons for company to failure. According to Austria´s Credit Protecting Association, illiquid customers account for only 2 percent and defaults by suppliers for only 1 percent of business insolvencies.

Business insolvencies are primarily caused by mistakes and weaknesses in business administration and operations. In detail, the causes of insolvency can be subdivided as follows:

|  |  |
| --- | --- |
| **Insolvencies in %** | **accounted for by** |
| 40 | mistakes made internally |
| 15 | negligence |
| 16 | shortage or lack of capital |
| 16 | external causes |
| 10 | personal faults by decision makers |
| 3 | other reasons |

Many business failures could be prevent simply if the entrepreneur had more in-depth business know-how and were able to apply it more appropriate. In particular, enterprises could ward off insolvencies if they paid greater attention to various internal and external warning signals.

Internal warning Signals

Finances

* Declining liquidity reserves
* Frequent use of overdraft facility
* Invoices cannot be paid at maturity
* Loans can no longer be serviced

Management

* Vague definition of responsibility
* Repeated delay in decision-making
* Apparent personal disagreements

Personnel

* Decline in operative utilization
* Decreasing productivity
* High labour turnover
* High absenteeism

Controlling

* Numbers are not current or not available at all
* Existing data is not properly prepared and structured and thus of little information value

Should it happen that an enterprise becomes illiquid and is no longer able to meet its financial obligations, it is absolutely mandatory for the firm to take measures instantly and actively seek a solution.

External warning signals

Customers

* Loss of regular customers
* Increase in accounts receivable and uncollectible receivables
* Frequent customer complaints

Competition and market situation

* Increasing competition, new competitors
* Decreasing market share
* Lower sales
* Increasing pricing pressure

Suppliers

* Declining supplier loyalty
* Inferior terms of delivery and payment (such as payment in advance)

Creditors

* Inferior conditions
* More frequent inquiries, declining trust
* Request for higher collateral
* Narrower line of credit

Political environment and laws

* New regulations or laws pending
* Request for changes in the law by media and lobbies

# Composition before and after receiving order

An illiquid company first tries to arrange in a so-called composition before receiving order or out-of court settlement with its creditors. It may suggest to them that the money owned will not be paid back instantly but over a couple of months. In case the situation does not improve, the company could even make the arrangement to pay back only half of the outstanding dept.

This might appear to be not a good arrangement for the creditor, but the alternative option could be the loss of the whole outstanding dept.

If the talks fail, the illiquid organization will approach the court and apply for initiation of “reorganization and rehabilitation proceed at court”, also known as composition after receiving order. This means, the court asks all the creditors about their claims. Then there is an attempt to find an agreement between the illiquid business and the creditors, with the judge acting as mediator.

This could result in a compromise that releases the debtor from parts of his dept.

# Liquidation bankruptcy

Liquidation bankruptcy means that the illiquid business is not able to pay the dept back anytime. In the first step, the company is sold, either in whole or asset by asset. Normally not all claims can be paid by selling the company. Every creditor is paid the same percentage value of his claim, known as dividend in bankruptcy.

Personal liability for the entrepreneur

The sole traders in a sole proprietorship, all partners in a general partnership, general partners in a limited partnership and all partners in a civil-law partnership have unlimited personal liability. The entire private property is used to pay the dept. If there is not enough property, part the further income will be used to pay the claims.

# Insolvency Proceedings

Invoices cannot be paid

Liquidation bankruptcy

Out of court settlement

Composition after receiving order