



INSOLVENCY & BUSINESS RESCUE

SME cashflow threats: ensuring that your contracts are worth more than the paper they are written on

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When a key commercial supplier, or valued customer that is benefiting from long-standing payment terms and a line of credit, suddenly defaults on its payment obligations, it can be a disaster for the SME that has provided the goods and services on credit.

SMEs which take pre-emptive steps, often survive the shock of a major default within the supply and commercial chain. Whilst steps can be taken by an SME in response to a defaulting supplier or customer, the real protection often lies in putting in place practices, checks, protections, before the default occurs.

It's all about timing. Contracts governing supply and payment, standard terms and conditions, and trade practices, are usually only reviewed after a payment default strikes. This timing is a mistake, because it is often only at this late stage that the contract's terms and trade practices are found wanting, when it is too late to effect the changes that will make a difference.

Steps to insulate the SME from the fallout of a default, include regularly assessing whether or not the SME's trading practice allows for the enforcement of valid contractual obligations. There are fundamental assessments and reviews that should be taken, to ensure that trade practices and commercial agreements can be relied upon as intended. This can go a long way to eliminate risks to the SME, which include the following:

1. Non-compliance with statutory provisions such as the National Credit Act (NCA), may nullify existing trading terms, or limit the SME's ability to enforce its contractual remedies when there is a breach. If an SME doesn't know whether or not the NCA applies, danger almost always lurks. Assessing the asset value and turnover of a customer can be essential. Attempts to enforce a contract can be fatally wounded where (for instance) an affordability assessment was not done, or where credit was extended recklessly. Proper systems and checks need to be in place, and the procedures need to be followed and fulfilled.

2. Ensuring that a contract was concluded, or that trading terms were altered, with a duly authorised representative of the supplier / customer, is essential, or the validity of the agreement is risked. The same confirmation of authority for the SME's representative, needs to be done. Resolutions, signed by the correct directors, authorising the relevant representatives, and permitting the act in question, need to be passed, scrutinised, and verified.

3. There needs to be a system for the SME to properly identify and verify the counterparty. Recording the incorrect name of the supplier / customer, or misidentifying the registration number, or citing the incorrect type of entity, may also raise doubts about the contract's validity, or complicate any subsequent claims or legal proceedings. The basic details of the supplier / customer must be procured and verified: the identity of its directors, and the location of its registered office and trading premises, are obvious starting points. The longevity of the company, and the existence of a website, can be indications of the track record. As credit facilities grow and payment terms lengthen, so should the investigation and verification of the supplier / customer be more stringent, and conducted at shorter intervals. Credit insurance might be considered.

4. An SME must investigate and know the status of the counterparty. Unwittingly concluding an agreement with, or entering a commercial relationship with, a liquidated or deregistered entity, or an insolvent, can be disastrous, and potentially void from the outset. This may leave the SME in the terrible position of having to seek to claw back money and goods from counterparties which have no realistic means of repayment.

5. An SME must put in place protocols that determine its actions to certain scenarios. If payment terms are breached, the credit facility might convert to COD. A letter of demand could be dispatched. Attorneys may be briefed. If a supplier / customer is teetering on the brink, urgent Court proceedings might be considered in order to perfect security and take possession of goods and debtors' books, before liquidation or business rescue commences.

6. If those processes commence without warning, then the early engagement of attorneys to protect the SME should be considered. Legal assistance will likely be needed to assist the SME to navigate business rescue's legal proceedings moratorium, the nature of the ongoing trading, and to assess the consequences to rights and claims proposed by a business rescue plan. Legal advice will be critical in liquidation, to guide the SME through the claims process, to participate in creditors' meetings, and during insolvency enquiries that are designed to recover assets or uncover claims for fraudulent, reckless or negligent trading.

An assessment of the validity and the ability to easily claim payment on the basis of a contractual default, should not be conducted after the default has occurred. It needs to be conducted regularly, and as part of the SME's ongoing business operations. Failure to do so will compound the problem and place at risk any attempts to seek payment. SMEs should be aware of this danger and timeously obtain the requisite legal advice to avoid cashflow risks.



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