



Under-capitalisation

I am often asked, 'What is the main reason a business fails?'

Under-capitalisation is always a heavy factor in every corporate collapse.

Under-capitalisation refers to any situation where a business does not have the necessary funds or 'working capital' it needs.

An under-capitalised business may be one that cannot afford current operational expenses, or it may be one that is over-exposed to risk, or one that is financially sound but does not have the funds required at start-up or to expand to meet market demand.

Under-capitalisation usually stems from poor financial planning. Many businesses don't have the appropriate capital from conception and struggle until they ultimately fail soon after they have begun.

Some easy steps a business can take to improve its working capital position include: regular invoicing, actively pursuing the collection of overdue receivables, stretching payables without incurring interest or penalties, renegotiating loans for lower interest rates and exploiting trade discounts.

Businesses can sometimes borrow against assets as a means to generate working capital. Business owners should be cautious about relying on external funding in circumstances where there may be underlying factors causing the poor liquidity that should be fixed first.

Injecting personal funds into a business is a typical source of capital but again, such steps should only be taken under the advisement of your accountant or advisor.

Don't erode your working capital unnecessarily through excessive drawings which will leave your business unfunded when times are not so good!

Getting sound advice before starting a business and during its life is essential.

Decision re CGT

A liquidator who sells a company asset for a price resulting in a capital gain is not required to hold those proceeds on account of the ATO under s254(1)(d) of the ITAA 1936 in the absence of a prior tax assessment by the ATO: Australian Building Systems Pty Ltd v Commissioner of Taxation [2014] FCA 116.

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