ES

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STAY IN BUSINESS

CONTENTS..

Working with those in business to stay in business.

WHY BUSINESSES FAIL AND HOW YOU CAN KEEP IT FROM HAPPENING TO YOURS.

Business Failure.

This is a phrase that strikes fear into business owners and entrepreneurs, and for good reason. Simply put, a lot of businesses do fail.

Why? This could be your product, your market, or uncontrollable and unforeseen economic events - or this could be you.

Ouch. That is not an easy thing to hear.

As an entrepreneur and business owner, you do not want to fail, and if this does happen, you want it to be despite your best efforts. You do not want it to be because of something you did or did not do.

Yet a lot of the time, that is exactly why failure happens. The person running the business does not understand one or more basic fundamental business principles, so they are not able to take the necessary steps for success.

Don't let that happen to you.

HOW TO AVOID BEING THE REASON YOUR BUSINESS FAILS.

In the over 30 years' experience of helping business owners, I have yet to come across a truly unique way of going bust. In the interviews conducted with business owners and entrepreneurs who have personally experienced business failure, I see the same problems over and over.

Understand the reasons why businesses fail, and take the steps to make sure that yours does not. Get control of the fundamentals.

Let's back up a bit and go over some numbers.

WHAT THE STATISTICS TELL US.

Statistics maintained by the Australian Securities and Investments Commission in Australia reveal the reasons why businesses fail.

- *Lack of experience*
- *Poor location*
- *Poor financial control*
- *Ineffective strategic management*
- *Cash flow planning*

Within the last couple of years, the US Small Business Administration cited these as the major reasons businesses fail.

- *Lack of experience*
- *Insufficient capital*
- *Poor location*
- *Poor inventory management*
- *Over investment in fixed assets*
- *Poor credit arrangement management*
- *Personal use of business funds*
- *Unexpected*

Here is a record of the top 5 reasons for business failure from the Dun & Bradstreet Business Failure Record, 1981.

- *Inadequate line experience*
- *Inadequate managerial experience*
- *Unbalance experience*
- *Incompetence*
- *Unknown*

Gustav Berle in The Do-It-Yourself Business Book adds the following two reasons.

- *Competition*
- *Low Sales*

WHAT THE STATISTICS TELL US.

Statistics tell us that experience, planning, and capital management skills are major factors for why businesses succeed or fail. See page 6 to see research results on business failures.

Although statistics like these are helpful as a starting point for understanding what could go wrong, they do not tell you the whole story. They certainly do not give you a way to identify and overcome the problems that may crop up in your own business.

That is why I've written this business fundamentals primer. Entrepreneurs and small business operators need to be able to find and fix leaks in the pipes before they become gushing rivers of lost money.

I have many years of experience working with struggling businesses, helping them to get back on track, and I have found there are seven big elements that determine success or failure.

Whether you are starting a business and want to get it right straight out of the gate, or you have become worried that maybe everything is not as it should be with your existing business, tackle these elements one by one to make sure you are on the right track.

WHAT I'VE GATHERED FROM YEARS OF WORKING WITH STRUGGLING BUSINESSES.

Get these elements right, and you are well on your way to a thriving enterprise. Get them wrong, and well… you end up talking to someone like me to try to avoid disaster.

Following are the top seven elements.

STARTUP FUNDING.

Startup funding is all about the money you will need to start a new business. Here are some of the issues you face when you make these decisions.

How much will you need? Expenditures fall into these three areas.

- One-time expenditure
- Operations
- Growth and expansion

Step One: Estimate your costs

This workup should give you a good idea how much cash you will need.

- Formulating your business idea, product or service
- Validating your business idea, product or service
- Licenses and authorizations
- Legal costs
- Accounting costs
- Insurance
- Rent
- Materials / inventory
- Business coaching
- Marketing
- IT systems
- Staffing costs - *salaries and other payroll expenses like workers' compensation*

You have probably heard the old startup adage "*Halve your revenue predictions and double your cost estimates.*" The point is, you should always expect something to come out of left field and surprise you, because at some point, it will.

Most businesses scream out undercapitalization or lack of startup funding – money is tied up in their working capital. When the cash is tied up, it leads to further problems. You delay production and your scheduling falls behind. That means you now need more money to cover overhead costs you had not budgeted for, which in turn reduces your profit. When your money is tied up like this, you tend to start relying on bank financing and avoid paying your creditors or taxes.

Next thing you know, you are a business failure statistic.

STARTUP FUNDING.

Step Two: What will be the source of the capital?

What will be your mix of startup funding – ***equity*** or ***debt***?
With both forms, you can raise money from traditional or other sources such as:

- Banks
- Friends and family
- Angel investors
- Government grant funding
- Crowd funding – *internet sites that facilitate funding for projects by collecting small contributions from the general public*
- Large venture capital investors

Equity

This means taking a stake in your business. You will only get a return on your stake if you make enough money to pay all the bills and have some left over; that is when you make a profit.

The more equity you give away, the more control of your business you lose. If the business is wound down, you will likely lose the lot, unless of course you sell your business for more than what you invested in it.

Debt

With debt you borrow money on a promise to repay the loan. The repayment comes with conditions. You will be required to pay interest and probably provide some form of security, whether it is in the form of the business, your personal home, or in many cases, both.

The more debt you take on, the more debt you have to repay, and if you get in over your head, the higher the probability that you may risk bankruptcy.

Whilst you make the loan repayments you are in control of your business. Miss the loan repayments and you will lose control of your business.

WORKING CAPITAL.

Working capital is the money used in the day-to-day trading operations. It is a measure of the current assets of a business less its current liabilities.

WORKING CAPITAL = CURRENT ASSETS – CURRENT LIABILITIES

Current assets include cash, debtors and inventory.
Current liabilities include any items which are due to be paid within the next 12 months.

Simply put, you need to have enough cash to keep the business liquid; that is, enough to pay the bills as they fall due.

Here is the tradeoff.

> **"Hold high levels of cash and stock, and you will remain liquid, but with lower profits. Hold lower levels of investment, and profits may be higher, but with greater risk to liquidity."**

Get this wrong and it will destroy you. Working capital is a complex mix of time and money, and you should have defined policies for it.

Policies around working capital

- What level should you have
- How to manage inventory, receivables and payables
- What level of investment
- How much of each – *inventory, receivables and payables*
- Who to have accounts with, what are the terms of trade

WORKING CAPITAL.

Ways to fund working capital

- Cash reserves – *subject to what return business owners want*
- Overdraft – *usually repayable on demand, with an interest cost*
- Fixed term loan – *usually long term, with a higher interest cost*
- Trade creditors – *subject to terms offered by suppliers*

Again, there is a trade off between risk and reward.

> "**You could fund your whole operations with *long term funding*, and whilst you will be liquid. It will cost you more, so profitability is lower. Using *short term funding* to cover the whole of your operations trades profit at the risk of liquidity.**
>
> Try to match short term funding with short term needs and longer term financing for your stable working capital and longer term asset needs."

The Cash Conversion Cycle

Making money is one thing and converting it into cash is another.

The cash conversion cycle is the number of day's cash sits out of the business (inventory and sales of account) less the days you can have with the cash in your business (how long it takes you to pay your bills).

How quickly can you convert the capital you invested from a spend, to putting it through whatever you are doing, to a recovery back into your bank account?

A very simple practice to get cash back into the bank is to make sure your customers pay on time. If you have given your customers 14 days to pay the amount you are owed, then you should make sure the amount is actually paid within 14 days. Letting this blow out to 21 days or more just means you are giving your customer a loan without charging interest.

WORKING CAPITAL.

Here are some issues that will affect how quickly you can convert your investment in working capital into cash.

1 What sort of trade terms are you getting and how long does it take you pay?

The more time you can get from those to whom you owe money, the better.

Paying accounts is a little tricky. How long you get to pay your accounts will depend on your supplier and the deal you negotiate with them.

Risk your reputation if you don't manage this well.

2 How long is it taking you to convert raw materials into items you can sell?

Take into account waste, inefficiencies, and losses.

How long does it take to make the goods?
How long does stock sit on shelves?

Improving these times will shorten your cash conversion cycle.

3 How much time are you giving people to pay, and how long are people actually taking to pay you?

Let's say your average debtor days equal 55. The more time you give customer to pay, the longer it takes to convert to cash.

You can play with the number of days customers have to pay – you could offer 45, 30 or 21 days. The better you manage this process with follow-up and enforcement, the shorter this period becomes.

CASH OR PROFIT.

Understanding the difference between profit and cash is critical.

Cash is the money sitting in your bank account.
Profit is the difference between revenue (sales) and expenses.

PROFIT = REVENUE – EXPENSES

Revenue *may include such items as a gain on the sale of an asset. Some revenues are not cash, such as gains in value of a stock.* ***Expenses*** *may include depreciation or amortization (these items are not cash either).*

Payments that do not go into your profit calculation include your principal loan repayments, tax payments, and asset purchases. Just because you have cash in the bank, does not mean you can spend it all. Some cash must be kept in reserve to cover deferred expenses.

The most obvious deferred expense is tax. Businesses have collapsed because they spent the money that should have been kept in reserve to pay their taxes and other large periodic expenses.

Just because you make a profit, does not necessarily mean your business is in good shape. If you do not collect what is due to you from your customers, or if you spend on investments or non-core items such as luxury motor vehicles, that profit figure is meaningless.

If you take the cash out of the cycle by spending it on items other than the ones for which it's been set aside, it needs to be replaced. That replacement may be in the form of borrowed money, which then increases your interest expenses and erodes your profit, or additional startup funding, which means you lose more control of your business to others.

STRATEGY.

Research, plan and document, but maintain some flexibility. In other words, make a plan, and expect it to change with circumstances.

Validating your business may be the only planning you need to do. We all make assumptions about our business. Validating is a process of testing those critical assumptions about your business, such that if the critical assumptions fail, your business would fail too.

Assume that things will go wrong; some of those things will involve factors that are outside your control such as economic and technological factors, or change in trends. There are some elements you can control, such as the people you employ and the client base you target.

Have a robust system of review and analysis, and try to keep a good, authentic support system around you (we will address this further down).

Here are the elements your strategy needs to address.

- How you use your startup capital *(see the first two sections on page 9 and 11)*
- How you position yourself in the market
- What you sell
- How you sell
- Your competition – *who else is in the game and how to play against them*

You need strategy to manage these elements. It is easier than you think, and it does not have to be perfect, but you do need a plan.

MANAGEMENT.

Just because you love or are good at doing something, does not mean you will be good at running a business, nor love it.

There are a few different skill sets that need to be in place on a successful management team.

- Product development and production
- Human resources
- Capital management

What we often see with struggling businesses is a manager or team that has strong technical skills but poor capital management experience. Without that critical element, it doesn't matter how good your product or service may be. A business, which by definition exists to make a profit, needs good money management if it is to be viable.

Good money management means:

- Balancing your start up capital – *how much startup funding do you need, what is the source, and what is the mix between equity and debt?*
- Getting your working capital right.
- Understanding what is cash and what is profit – *how much of your profit gets invested back into the business and how much goes to stakeholders.*
- strategic planning for all of the above.

BUSINESS LIFE CYCLE.

How much capital you need, where you position yourself strategically and how well you need to understand business will depend on at what stage you business is positioned in its life cycle.

- Pre-startup – *product/service validation*
- Startup – *the business is unstructured, simple bookkeeping, simple product/service lines*
- Survival – *the business is gaining some traction, channels firm up with increase in sales*
- Growth – *market gets broader, but still simple product/service lines, start to develop systems and more management skills needed*
- Expansion – *products/services broaden, systems become more sophisticated*
- Maturity – *you are the top of your game*

You will face different business issues at different points in the life cycle of your business.

For example, a pre-startup will be grappling with its product and testing its validity.

Compare that with a business in its growth or expansion cycle, which is about funding growth of the business or introducing new product lines or markets.

Simply making it from one cycle to the next does not increase your chances of survival. In fact, the old cliche *"The bigger they are, the harder they fall"* is true. A more mature operation has a lot of resources invested, and so has a lot at risk.

If you do not have proper management, you will simply fall harder.

ADVICE, SUPPORT AND SHARING.

Sharing, seeking advice, and getting support makes good business.

Just searching and reading this primer shows you are looking for advice and support, which puts you ahead of everyone who is trying to go it alone.

Surround yourself with others who are facing the same problems and issues, and not just those in your own industry. Diversity is a bonus, because it lets you see a common problem from a fresh perspective, and that allows for solutions that you may never have considered had you stayed within the boundaries of your own niche.

WHAT TO DO WITH THIS INFORMATION.

Now, you do not have to be Einstein in dealing with these critical business elements.

You do need to be aware of them, address the key fundamentals, and have a plan in place to deal with them, so you do not lose control.

Reading this primer is a good first step, but there is a lot more to explore.

Here is what to expect next.

- A series of emails that will explore the seven factors more deeply. These will include checklists and short tutorials, so you can take action instead of just reading about it.
- Regular updates.
- Detailed information around key business fundamentals.
- Stories from others in business, so you can see how other people have found solutions to their problems.
- Information about my latest training sessions and other learning tools, such as webinars.

I welcome the opportunity to talk to you one on one. Help me find out more about what it's like to be in your business.

And as always, if there anything at all that is causing you confusion, please let me know. I welcome your questions and feedback. You can reach me here:

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