Recession Proof Your Business

Just as evolution in animals dictates that only the fittest survive, in a recession it is generally survival of the smartest.

In this country we seem to have a recession-like economy happening every seven to nine years and almost 75,000 Australian businesses were wiped out in the last downturn. To survive business owners must find a way to plan their way past potential threats including higher interest rates and fuel prices plus declining consumer confidence.

In recessionary times business owners must strike a delicate balance between pessimism and optimism, ensuring expectations are realistic but not giving up on growth. Smart business owners know that a recession presents an opportunity and it's time to spend more time working **ON** your business rather than **IN** it

In good times the weaknesses in a business can be hidden but when the going gets tough, both the strengths and weaknesses will surface. Problems emerge when bad financial management habits spill over into tougher economic times. As your accountant our role includes identifying those weaknesses and helping you amend the strategic direction of the business. We combine the knowledge of your business with our experience and some 'intelligent' forensic software tools to detect the early warning signs and then work with you to develop strategies to move forward

Don't sit idle with a wait and see mindset in the event of a downturn. Be pro-active and try and recession proof your business by driving increased productivity and growth using these ideas. There is no magic bullet to recession proofing your business but we have compiled a list of 10 strategies in a bid to help grow and protect our clients because ... Small Business is Our Passion.

Improve the Quality of Your Financial Records

In boom times it's very easy for business owners to ignore the quality of their financial reporting system and turn a blind eye to financial management issues. Unfortunately when these bad habits spill over in to difficult economic times it can have catastrophic consequences.

The most basic requirement for a successful small business is good accounting records. Up to date, accurate financial records lets you make informed business decisions. They provide vital management information needed to grow your business and monitor key performance indicators.

Despite the introduction of GST some 8 years ago, the majority of small business owners are still using accounting software beyond their business needs and level of accounting skill. The net result is they generally produce 'computerised shoebox' records that should not be relied upon when making financial or strategic business decisions.

If you don't understand double entry accounting principles including debits and credits, it is time to review your accounting software. As a rule of thumb, you should have financials available within 7 days of the end of each month. This is supported by an Australian survey that suggests that a business' very survival depends largely on timely and accurate records.

You will also need good accounting records to demonstrate your financial position to banks, other lenders and prospective buyers at some time in the future. These parties will want to track your historical performance and will demand current data. The Tax Office also requires you to keep and maintain business records including source documents for at least 5 years.

Well managed businesses produce a 'weekly snapshot report' of:

- Sales
- Debtors & Creditors
- Cash at Bank and On Hand
- Sales Pipeline
- Work In Progress
- Other KPI's

Failing to Plan is Preparing to Fail

Historical data is important but you'll 'crash' the business if you drive it by just looking in the rear view mirror. Today's decisions will impact on your future results.

If you don't have a plan in place or prepare an annual budget or you are asking for trouble when the economy turns south. It's easy to get complacent during the good years but a budget creates a blueprint for the future that you can measure your actual performance against. Cash flow is usually the most common client concern, the most visible and therefore the most painful. By identifying all the activities that turn work into cash and then measuring those activities, the results can be immediate.

A budget can identify if and when you expect to need additional finance. While generally we prepare budgets at the start of each financial year, your budget is always a work in progress under constant review. The banks are tightening their credit policy in the wake of the sub-prime lending crisis and planning the finance application is absolutely critical.

Cash is more often than not the reason why so many businesses fail. Profits can't be spent until they are collected. It is obviously important to sell at the right price to maximise your gross and net profit but if you don't focus on collection, the business won't last very long. A positive cash flow is an absolute necessity if your business is to succeed and it just doesn't happen - it needs to be planned. That's why we strongly recommend the preparation of a 12 month cash flow budget. In fact, any business that fails to accurately forecast its cash flow is on a collision course because without realistic cash flow projections, management is unable to identify future cash shortages.

The cash flow budget is based on a number of assumptions regarding the expected future performance of the business. The assumptions must be realistic and supported by research, available data plus known facts such as rentals or forward contracts.
The information in your cash flow budget is designed to:

- forecast your likely cash position at the end of each month
- identify any fluctuations that may lead to potential cash shortages
- plan your various taxation payments
- schedule any major capital expenditure, and
- provide prospective lenders with key financial information including loan serviceability

After you have completed your cash flow budget and you're confident that it actually reflects your predicted position, you should be able to identify if you're likely to need an injection of funds to support the business. Careful planning might let you restructure the timing of certain payments to prevent the cash shortfall occurring or you may need to have finance facilities in place.

Being a financial tool, accuracy is important but this can be difficult with forecasting. We can assist you with the preparation of your cashflow budget using computerised spreadsheets that allow us to produce forecasts based on a number of 'what if' scenarios. If you would like a copy of an 'electronic cashflow worksheet' please contact our office. Our preferred accounting software program, Cashflow Manager can generate a budget using historical data at the click of a button. We can then monitor variances on a monthly or quarterly basis.

Unlock the Hidden Cash

If changing economic conditions are going to put a squeeze on your business, the first place you will see the signs is in the cashflow statement.

Of course, positive cash flow alone is not enough. The business must be returning a profit and the long term trend for both must be positive. You will not only need to make sure your business is profitable, you also need to make sure you have enough cash available at the right time to pay all the bills. In particular, you must be able to pay your suppliers, staff and meet your tax liabilities.

If you do a quick estimate of how much money you have tied up in debtors, suppliers paid too quickly, excess or slow moving stock and work not invoiced you might find it's worth investing some time to address these four areas. It might put some funds back into your account and reduce your interest bill if you run an overdraft.

There are many places your cash can be hidden other than in your bank account:

- Debtors - unpaid customer accounts. Do your statements go out on time? Are you monitoring the customers who don't pay within your terms? Consider printing the actual due date on your invoices rather than the standard 30 or 60 days. Follow up delinquents. Remember, the 'squeaky wheel always get attention'. You are not in the business of 'bank rolling' other businesses or customers.
- Suppliers might be paid too quickly. As you know, the supplier who rings and annoys you for payment often gets paid first when they shouldn't. Worse still, the part time bookkeeper that pays bills the moment they arrive. This can play havoc with your cash flow and you need to use up all your available terms and even negotiate better terms if you can.
- Investigate alternative suppliers and explore their prices and terms. Keep your suppliers on their toes and make sure your suppliers earn your business
- Work in Progress can be a real hiding place for cash. If you have multiple jobs on the go at once it can be difficult to manage and get them to the point of invoicing. There can be all kinds of delays from slow delivery of parts, labour issues, getting access to job sites etc. If you are tracking stock manually or in your head without any process then it could create big cash flow headaches.
- Stock is really cash piled up in your store room. Do you have any methodology behind your stock purchasing? Many businesses buy when the sales rep calls or if they are offered a discount. You should only buy stock when it suits you, not your supplier.

The objective of any retailer or wholesaler is to have your stock on the shelf ready for sale for the shortest possible time. Put simply, stock is money because it absorbs precious working capital that could be used for the other things like advertising, wages and expansion costs. If you have borrowings in your business, excess stock could be costing you interest.

Vital to this objective is to know the sales cycle of your products, i.e. how long does it take from when the goods arrive into stock until when they are sold. You may have historical data upon which to calculate the sales cycle. If not, you need a way to calculate how long goods are sitting in stock so that you can minimize the length of time and maximize your available working capital. This is called 'Stock Days' and is an average of all stock lines. One way to calculate 'Stock Days' by using your financial reports is as follows:

Stock on Hand ÷ Cost of Goods x Time Period = Stock Days

- Stock on Hand means the dollar value of stock on hand at a given date, e.g. June 30
- Cost of Goods means the direct costs of getting the goods ready for sale, including purchase of the goods, freight inwards, store costs (but not fixed overheads like administration wages or advertising)
- Time Period is the reporting period upon which you are basing the above two numbers.

A business with $150,000 in stock at June 30 and Cost of Goods for the year of $400,000 has 'Stock Days' of 137 i.e. $150,000 ÷ $400,000 x 365 = 137.

This means that, on average, stock in this business takes 137 days from when it arrives until it is sold. Once you know this number you are then in a position to manage the situation and work on shortening the cycle.

Again, a good stock control and record keeping system is required that tells you the following:

- What is selling
- What isn't selling
- What the slow moving items are
- What has become obsolete
- What the trends/seasonal patterns are
- What your margins are on items; and
- What it is costing to store stock.

You can determine your minimum and maximum stock level requirement for various items lines. This makes it much easier for staff to know what, how much, and when to order.

Obsolete stock can be a real 'hiding place' for cash. It's tough to sell items at a loss, but if they are going to sit there forever, you may as well turn them into working capital to spend on better selling items. If you have good records you are also in a position to know how much you are purchasing from suppliers. This puts you in a better bargaining position when it's time to renegotiate prices and terms.

7 OTHER WAYS TO RECESSION PROOF YOUR BUSINESS

We have documented 7 other ways to recession proof your business that are exclusively available to clients of this accounting practice. We are not your average accounting firm that just keeps the 'score'. We aim to work with you to build a stronger, more profitable and valuable business by combining our consulting tools and expertise with the knowledge of your business.

Small Business is Our Passion

- Know you average stock days and work on shortening them.
- Sell or dispose of obsolete stock.
- Have a purchase ordering system.

- Know your sales cycle and manage it.
- Purchase stock based on your sales requirements.
- Know your minimum/maximum stock levels.
- Have a system/computerised stock management; and
- Know your industry average stock days.