The Money is **in the Numbers**

Understanding Business Finance

BookkeepersHub
Connecting Australia's bookkeepers with business

Contents

BookkeepersHub

Bookkeeping should be a highly profitable business

Yet for the vast majority of bookkeepers, it feels like they are running hard and standing still as far as achieving anything like a high income. What's going wrong? Does this resonate for you? To be realistic there is no silver bullet; but there is a mindset than can help you realise higher profits from your bookkeeping business and ensuring that you thrive.

The truth is we should never underestimate how much a business-owner needs their accountant or bookkeeper. And that is despite how much of the traditional work of accountants and bookkeepers can be automated. The fact is that many business owners still use a physical book to record their business finances. Automation brings in opportunities to be more efficient, no more chasing of paperwork, no more deciphering random numbers written over receipts and bank and credit card statements

Improve your practice every step of the way. Here we will outline methods and practices that will improve your practice every step of the way. Our focus is on how to:

- Attract better clients
- Value price your services
- Deliver higher profit service

First understand this truth: we should never underestimate how much a business owner needs their bookkeeper and accountant. And also never forget that a huge number of business owners still use a physical book to record their business finances: shoeboxes still appear days before tax time!

Importantly, you need to have a good sense of numbers, not just those of your clients, but of your practice. It is numbers that will drive profits and our goal is to build your practice on the back of 'improving' your numbers.

There is money left on the table

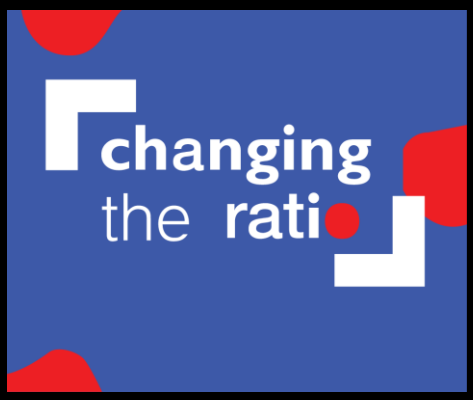
Yes, most bookkeepers leave money on the table and the best way to ensure that you are *not* leaving money on the table is to make sure you are tracking the monthly bookkeeping revenue in your accounts. This seems obvious but equally important is to track how many clients you are receiving are providing monthly services to and how many people (in terms of hours contracted) are involved in providing these services. This gives us three very important ratios:

1. The number of clients per bookkeeper (this may be a fraction)
2. The average client revenue per bookkeeper (that's arrived at by dividing the total revenue by the total number of bookkeepers)
3. The cost (average) per client of servicing (total staff or contracted hours cost divided by the number of clients).

This arrives at what we call a *productivity metric*. Whatever the number is at present, we commence the work of driving this metric higher. The higher figure ought to become the benchmark for achieving the kind of profitability that you deserve, that is, rewarding you for the efforts made in improving this ratio.

CHANGING THE RATIO

Understanding ratios and metrics is essential for building your firm's profitability; no matter how good your client relationships are how successful you have been in acquiring good clients. It is the ratio of average revenue per client that needs to move upward.



By way of illustration, let's assume a firm has 15 clients and the firm employs one full time bookkeeper and one par time contracted bookkeeper (50% billing basis) to service this number. The ratio here is 15/1.5 or 1:10. If say the revenue was $5000/month arising for this firm and you improved the ratio to 1:20, you have doubled the revenue per month on the same cost base. Assumptions can be made on the contributions to revenue and profits:

- 33% direct costs
- 33% overheads
- 33% profits

These would vary from firm to firm, but it enables a firm to arrive at targets for achieving an optimal ration and a much higher profit. The key is to lock in a cost base from which to drive a higher ratio. Let's assume a cost base of $5,000/month and achieving $5000/ month profit – not a huge return on your skill and efforts! So you are seeking to achieve a profit of say three times your cost base – not an unreasonable goal. That is $15,000/month. That increases the ratio significantly – you are moving the dial in your favor that is you are increasing the average revenue per client. To be clear, this is not about productivity gains; it's about different pricing. In simple terms you will double your profit (on same cost base) by doubling your key ratio: ***the bookkeeper to client ratio***.

Steps to increasing the ratio

To receive twice the revenue on the same cost base requires much self-analysis. Am I truly worth twice the cost? Am I able to justify this increased value to the client? There a number of key drivers to resolve these questions, not the least of which is to believe that your services are, indeed worth more. There are others:

- Incentivizing each bookkeeper/contractor in the firm based on the revenue of the pool of clients under management
- Train the team in upsell. That is, train the team in selling services that you offer but which were not part of the opening gambit when onboarding the client
- Encourage each of the members of the team to be a 'leader", that is to 'own' their relationship with the clients they service and to believe in the value proposition on offer by them
- Transition your clients across to new recruits to maximize the load to demonstrate what can be achieved. In short: replicate and duplicate
- Above all, be efficient on the practice; encourage clients to submit invoices, receipts etc. in a complete and tidy fashion. Chasing documents erodes the optimal ratio.

While the one-third of the *revenue=cost* assumption is an arbitrary figure, it nevertheless operates as a benchmark against the key ratio. The cost per client is a pivotal number so get a good handle on it and keep pushing the client number!

Expand your capability

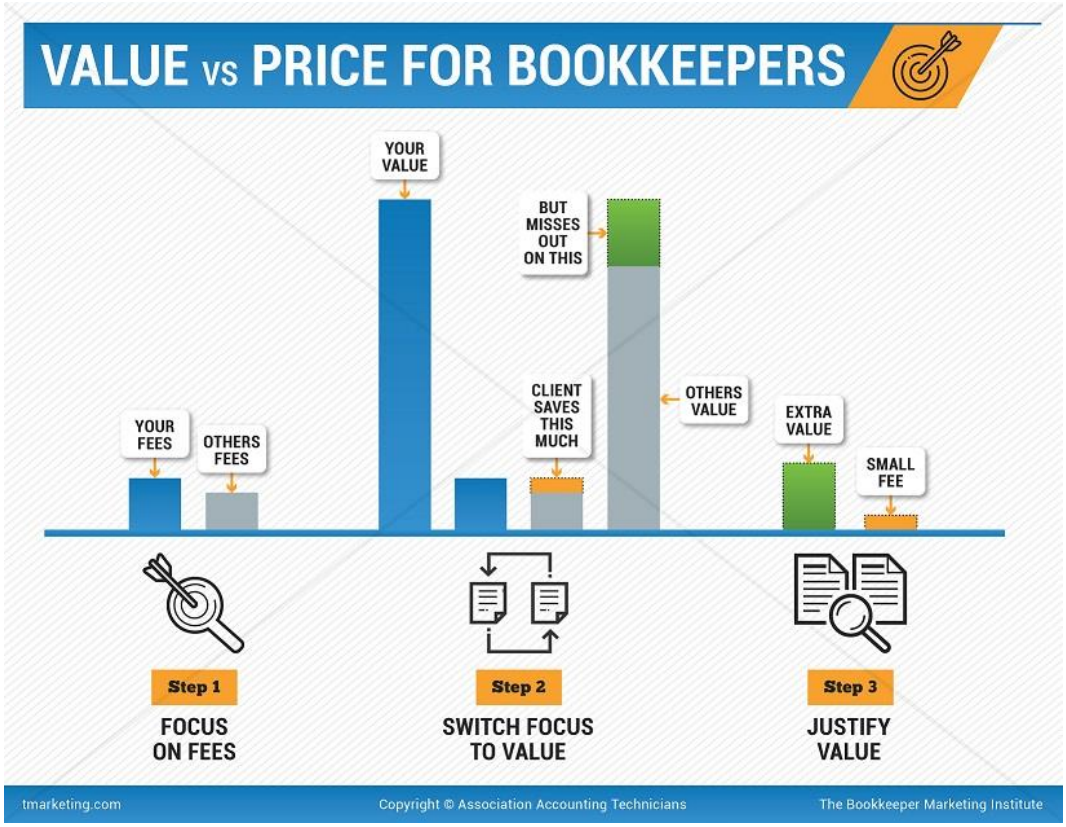
You need a granular view of the services you are to provide and have communicated that there is a monthly price. Your price needs to be guided by your expectation of achieving a higher ratio. Price is a key driver. The proposal that includes a price is pulling together in one place the elements you have agreed and presenting them for final approval.

There is more than just shifting the ratio to improve your bottom line; above all, the goal is to make your firm is more efficient and giving the client an enhanced experience. For sure it is important to be price competitive, but the real job is to create time and an increased capability.

The scourge of many practitioners is scope creep, which is both a mindset issue (fear of upsetting the client) as well as an efficient issue. Skills matter too when it comes to specialised services in particular and advisory-type services where additional training and upskilling may be required.

The underlying premise behind the issues raised here in this eGuide is that productivity never ends. There are always areas for analysis and improvement. If the ratio can be significantly improved by 100 percent you don't need to spend four hours per client per month, you spend just two hours.

Know your numbers



Value matters for both the practitioner and the business. The balance between value and price needs to be right for both parties.

The productivity tool: *the ratio*, is a great tool for the progressive bookkeeping business owner but equally important for the practitioner is the need to understand the language of business. Working with accounts can be mid-numbing and largely, a rear-view of the financial health of a business. It is a whole other thing to get a handle on how a business is traveling in real time and understand the significance of ratios and metrics such as key performance indicators.

We cover some of the basics here, noting that we have produced a comprehensive guide to business finance for the practitioner to gain a deeper knowledge of business numbers as expressed in finance matter. The eGuide is available at www.bookkeepershub.com.au/shop

Here we will focus on the importance of a business owner staying on top of their Key Performance Indicators.

Business finance

You don't need to be an accountant to build a great business, but you do need to have systems that measure the things that matter in your business. Of course, there is finance; cash flow, stock control, inventory, accounts management. But what is the ecology of the business – sustainability via measurable indicators?

What to measure

Gone are the days when fast talking salesmen can raise capital, bludgeon others to buy their products and services, juggle all the balls in the air and – hopefully – some years later reap windfall gains. Today we need a more systematic approach.

The ultimate goal of imposing structure and instituting systems is, of course, predictability. For many, first hearing terms like "cost of sales" belongs to the bean counters, not aspiring entrepreneurs. But in an environment where cash flow means life or death (of a business) such terms must be paramount for all key decisions makers, and this becomes increasingly important. Like everything else associated with growth, predicting the course of a business becomes more difficult as revenues – and stakes – increase.

The dashboard approach

What are the measurements that matter to you? It would obviously be useful if you could glance at a business dashboard and know exactly how your business is traveling, so just what are the indicators that would be highlighted there? How easily (and quickly) should you be able to get crucial information on your key performance indicators? Do you know what to look for?

An 'enlightened' business owner can choose to run a business anywhere, from a laptop. The laptop is the dashboard. In one look, you can see total sales this month and year-to-date, overtime hours worked, delivery schedules against plan. Most importantly, you see your backlog of orders. Another page on the 'dashboard' shows your daily profitability figures, key inventory efficiency ratios, and an aged debtor list.

The question for any business operator is, are you driving blind? Most business owners know exactly what's important to their enterprise, but don't do what's required to have this information at their fingertips. Some don't even do the metrics at all. Each business has its own unique set of indicators which tells the owner (and often the bankers!) exactly how the business is traveling.

These are not financial statements; these are historic figures and don't represent 'critical' indicators of the kind represented on a dashboard. They are the numbers that determine the business success. In a manufacturing plant, the critical number might have throughput or production efficiency. If you run a boutique hotel, you would like to know the percentage of rooms filled or booked.

If you've been running your business for a while, chances will be that you have a good intuitive idea of your critical numbers. They keep you up at night when they aren't behaving the way they should. The problem is, most owners don't take full advantage of a 'dashboard' approach, either watching last year's figures or none at all. Many things are measurable, but not key to the organisation's success. In selecting Key Performance Indicators (KPIs), it is critical to limit factors to those that are essential reaching goals. It is also important to keep the number of KPIs small, to keep the team's attention focused on achieving the same KPIs.

You need to:

1. *Identify the key measurements and key performance indicators* that are important and essential for your business. Limit this to five or six indicators, e.g. a mix of production- and finance-related figures, or a sales/financial mix of indicators. Work with key staff and your accountant to draw out the list.

2. Set up an active system to *measure and track these indicators*. You could use existing software and print information daily, or use a more sophisticated web-based, interactive, real-time display. The key utility of the dashboard approach is based on getting data daily. They key indicators should be visually highlighted and, for greater impact, show 'hot' zones – those needing immediate attention.

The dashboard can be used daily to decide which areas of your business need attention and which are opportunities for targeted growth or specific strategic input. Dashboard indicators are not static, so look for trends. As you get better at using the numbers, enhance the value by seeking best-practice indicators from industry associations. Ultimately, it will drive your business to profit.

We need to look at the facts, and this is done by looking at the numbers. By looking at these facts, you can then work out how to improve your business.

- What are your total sales for the week?
- How many new customers came in the door this week?
- How many of those bought something?

Here's an example: If you had 100 new customers and 20% bought a service or product, with a combined value of $20,000, then you would know your average sale is $1,000 (100x20%=20, $20,000/20=$1,000). So what if you want to increase sales? The first thing you should focus on is the front end; more customers. If you got 150 in the front end, then the numbers would work out:

150 x 20% = 30, therefore $30,000 in sales.

Now, if you focused on increasing the conversion rate, which is to say improving your selling process either through training or using more successful methods, then you might be able to get a 5% better conversion. So the picture looks like:

150 x 25% = 37, therefore you'd have sales of $37,000

By identifying the KPIs of your business, you can increase production to be more viable. This philosophy also applies to your suppliers; what are their numbers? What did they produce in a given time frame? Although it's unemotional, a good hard look at your KPIs will be rewarding. It's the business path to prosperity!

Benchmarking

Benchmarking is a process of comparing your business characteristics with others; more than identifying where your business is under-performing, it is also creating and implementing changes to boost performance. When benchmarking your business, you have a number of choices about whom and what you consider it against. Competitors may have many characteristics in common with you, so learning about work practices may lead to a competitive edge for your business. Depending on your industry, current needs and some of the indicators noted in last section, a benchmark can be limited to one area of your business (e.g. customer service) or be a general overview. Some common characteristics are:

- sales, turnover and profitability
- products and services
- pricing structures, fees and overheads
- key performance indicators
- quality control processes
- customer service standards or the number of customers
- staff management and turnover.

Benchmarking is of limited value unless you use the results to improve your practice. Having seen where there are weaknesses in your business, the next step is to make changes to strengthen those areas. For example, a transport business may find its vehicle breakdown and replacement rates are significantly higher than comparable companies. The action may be examining maintenance policies and changing the quality-control processes in the servicing department.

Remember that there may be perfectly valid reasons for poor benchmarking results. You could have made other investment priorities; for example, if your engineering business lags behind others in its marketing spend, it may be due to recently investing heavily in research and development. It's also possible that your business objectives differ from your competitors and although outgoings in your business are higher, it is for maintaining a city-centre presence as a strategic decision to which your business is committed for customer-service.

Critical numbers

Finance can be boring, but it doesn't need to be - particularly if we understand why it matters. Numbers show how healthy our business is, and what we need to do to improve its performance. The information in a financial statement comes in two parts: the balance sheet and the income statement. The balance sheet is a picture of the business at a specific moment in time. It reflects various aspects of the health and strength of a business by listing its assets, liabilities and net worth (also referred to as equity).

Assets are the things owned by the business. Assets can be broken down into two types: current assets and fixed assets. Current assets are those that could easily be converted into cash within one year (such as cash itself, inventory and accounts receivable). Fixed assets are things of a more permanent nature, that are not very easily converted into ready cash, like land, building, the business car, office equipment, leasehold improvements, furniture and fixtures.

Liabilities are the amounts owed by the business, or a listing of debts. Current liabilities, as with current assets, are liabilities that will be due within one year (accounts payable, short-term facilities due to the bank, expenses you have incurred but not yet paid the current portion of any long-term debt, etc.). Long-term liabilities are liabilities that become due one year or more in the future (e.g., the balance of any long-term debt not included in current liabilities).

The other essential part of your financial statement has a variety of names: the income statement, operating statement, profit and loss statement, P&L. By any name, it summarises activity over a period of time, usually 1-12 months.

Assessing working capital needs

Working capital is the fuel for a business. Without it, there is no business. A business owner needs to have the capability to make informed decisions with a clear view of how they impact working capital. Here is an example:

Based on balance sheet projections and their statement of change in financial position, Widgets Ltd identified the following increases in accounts receivable, inventory, accounts payable, and other working capital accounts. The business will need $200,000 to fund the changes it is predicting.

Widgets Limited

Accounts Receivable	$ 100,000
Inventory	$ 75,000
Subtotal	$ 175,000
Less: Accounts Payable	$ 50,000
Net Working Capital	$ 125,000
Other Working Capital Accounts	$ 75,000
Net Change In Working Capital	$ 200,000

Understand the Cost of Sales

The top entry on the income statement is sales or revenue. The next entry down is cost of goods sold (COGS); representing what the merchandise you reported under sales actually cost the business. Once you subtract COGS from sales, the result is gross profit, also known as gross margin. This is the margin dollars left after the COGS is subtracted from your sales. But you can't stop here! The next series of entries on your income statement are your operating expenses, and may range depending on your size and tolerance for detail. Most computer-generated reports allow a manager to track operating expenses in excruciating detail. They are often listed alphabetically, e.g. 'advertising', 'bank charges', 'motor vehicle'.

Every business will have its own dominant or key financial indicators, such as:

- Selling expenses, including all expenses directly attributable to selling your merchandise; salaries or commissions for salespeople, advertising, supplies, travel and entertainment, portions of payroll taxes and benefits.
- Occupancy expenses, including things such as rent, utilities, equipment, maintenance - all that which allows you to do business in your location.
- General and administrative expenses, including administrative salaries, taxes and license fees, training, insurance, office supplies, etc.
- When your operating expenses are totalled, they are subtracted from your gross margin to arrive at net profit. But do not stop here! Net profit is only a number. It is not cash; you cannot write a cheque for it, and it certainly doesn't pay bills.

Cash indicators

For start-ups and growth businesses, cash tends to burn up quickly. Keep a very close eye on burn rate vs. revenues. Burn rate, in this context, is a lot like fixed costs, but more. Fixed costs are what you'd pay even if your business closed down. Burn rate is what you pay regularly every month to keep your business running, but without the variable costs of sales or direct costs. It includes all of your salaries (unless you have some assembly labour or part-time labour that goes up and down with sales), your rent, your office expenses and all the rest. If your revenue goes down, you can maintain your burn rate for a while by sacrificing profits, but you can't let revenues stay under the burn rate for very long without losing capital and, if the problem continues, going under.

Manage Cash Flow

Cash flow management is one of those crucial activities that success or failure will literally be dependent upon. Cash flow is the money that enters and exits a business through receipts, payments, drawings, and cash sales. 'Profit' is total revenue less total expenses for a period of time, calculated in accordance with generally accepted accounting principles. So, cash flow is simply the 'cash in, cash out' fluctuation of doing business. A cash flow statement is an important planning tool and should be charted on a weekly or monthly basis, projected over several months.

'Cash is king.' It may be the maxim of business finance, but it's not a useful phrase. Many people who toss that cliché around fall short in trying to explain exactly why cash flow is so vital to a business's financial health. Here's the short answer: If a business doesn't have enough cash on hand, it can't pay its rent, meet its payroll, or fund its day-to-day operations.

You can be making good profits on the reliable sales that come in, but if revenue hasn't arrived in the business bank account, the business may not be able to pay the electricity bill. As long as more money seems to be coming into the business than going out, many owners don't give cash management a second thought, and that leaves them vulnerable to a lot of cash-flow danger.

Luckily, the first step to improved cash management isn't exactly brain surgery: just start maximising cash flow by making sure that billing, collections and accounts payable systems are operating as efficiently as possible. Invoice promptly, aggressively follow up on overdue bills and request up-front deposits when making sales. Then hold on to your cash as long as possible by managing your payables; take as long as you're allowed – without incurring late fees or interest charges – to pay your bills.

Cash crises happen. The way they're managed can have a tremendous effect on a business's all-important relationship with creditors. Some of the symptoms – a number of which have already been raised – of a business cash crisis include:

- constant difficulty paying creditors by the due date
- exceeding your bank account operating arrangements
- your cheques being bounced by the bank
- your creditors threatening to cut you off
- Tax payments becoming overdue, especially GST!

By managing these areas, you can minimise business risk and help improve your chances of succeeding. Telephone your creditors to schedule meetings before payments are due, and don't schedule meetings after you have run out of cash – move decisively to meet creditors well before any critical date. Always leave yourself enough cash to make a token payment, demonstrating good faith. You should also develop a credible action-oriented business plan. Aim for a realistic assessment, then focus on how to fix crises. Above all, never promise anything you already know you can't achieve. Your plan could be, for example, a staged repayment of all outstanding amounts while keeping credit alive for new orders.

Of course, good management should always aim to avert crises. This, again, is about monitoring and managing cash flow and ensuring that you take the necessary steps to check the creditworthiness of your customers.

The financial forecast

Forecasting is not an exact science, but it is certainly better than crystal ball gazing. Financial forecasts set the scene for business planning, and for cash-flow management in particular; they ensure the business is continually pointed towards profit. You need to be clear about what assumptions you build into the forecast and where they come from, because your assumptions are as important as the numbers themselves. Assumptions may require research, for instance, into industry data (future growth), demographic data and customer surveys.

Putting together an optimistic annual sales forecast based on gut feelings and wishful thinking will not be useful; in fact, it creates a whole clutch of problems next year. Wrong decisions may be taken as a result; by the time you discover your mistake, it will be too late. You'll have geared up, either by buying too much stock, taking on new employees or, worse, by expanding into new facilities. You'll be fielding customer complaints of quality or deadlines, as you desperately seek sales. Your bank will be calling. You'll be worrying about cash flow. Bad forecasts are bad business. Fortunately, there are some rules you can follow to increase the likelihood of making a sound revenue forecast – a forecast you can make decisions around, and most importantly, get people to support and strive for.

Rule 1: Make estimates, not guesstimates

Start by declaring the annual growth rate that you (or senior management) are looking for. I'm referring to the increase in sales you expect, not just in the coming year, but year after year. No one needs this information more than the people responsible for assessing where the sales are coming from. Once you have a forecast growth rate, consider how to develop of sales opportunities. Can you develop opportunities fast, while taking care of people? Your sales people must give management an honest assessment of what they can do.

Rule 2: Insist on information, not opinion

Most business operators and chide executives are sceptical of the forecasts they get from their sales people. 9 times out of 10, there's no substantial evidence to support numbers. In this context, evidence is the hard facts that will directly affect your customers and their future purchasing decisions. If a sales manager declares a product's sales will go from $100,000 to $200,000 next year, you must ask why: 'Are we doing more promotions or cutting prices? Are competitors increasing theirs? What is the likely response of our competitors? Are new competitors entering the

market?' You need to make sure they've considered what might go wrong. Your people can get the answers to such questions by researching your market segment, talking to your customers, and doing on-the-ground networking.

Getting banks to say 'yes'

While getting a loan from a bank can be tough, these steps should make the road a little less rocky and improve the odds of getting the financing you need. Firstly, carefully craft a *business profile*. This does not have to be a long document or cost thousands of dollars for consultants to produce. You simply need to woo the potential lender with the numbers. Give those real numbers about your business's financial history, and projections for future performance.

Making a persuasive case

This is the 'why' of giving your business the money; what it is for and why it makes sense for the bank to lend it to you. In other words, demonstrate your creditworthiness and how you will pay back the loan. An effective business profile document needs to be comprehensive in a number of key areas:

- Demonstrate the natural flow of work and cash for your business in descriptive and in cash-flow projection terms.

  Show how you have funded the business to date, explaining where you are at in the business life cycle, how this influences your financing options, and your personal assets and liabilities.

- Answer, 'What do you do?' by using your mission statement if you like, but keep it pithy. Also address the following questions: 'Who is your market? Who buys your goods or services? What is the size of your market? Who are your competitors out there? How will the current proposal increase your share of the market, or do you plan to increase your business with existing customers?'

- Include a compelling *executive summary*. Most business profiles have a strong, short (paragraph or two) summary stating how much money you need to raise, backed by a statement of how the money is to be applied.

- List your business skill base in terms of expertise in your management and staff. What is their track record for successful business practice?

- Set out how you will repay the loan; whether the payments will come from operating revenue, or some other area such as the sale of property.

Banks like to see projections for at least 12 months. Getting a loan is more complicated if your business is a start-up. At the very least, your business profile will need two sets of financial statements:

- *The financial history of the business* (usually 3yrs). Include profit/loss statements and balance sheets. You may be required to include tax returns for these years as supporting documents. You will also be required to provide credit reports, indicating whether or not you pay your liabilities.

- *Financial projections*. Prepare projections for how the loan will be spent and how those expenditures will affect your bottom line for at least the next 3 years. You need to show risk factors that may prevent you from achieving projected results. Risk factors may include: less than targeted market share or revenue, under-budgeted costs, loss of key staff, competitive response. Show what level of sales will be needed to break even on the plan.

Finally, some other obvious considerations that must be taken into account:

- *Ask for the right loan*. Before you approach a lender for money, make sure you're choosing the right financing tool to do the task. For example, cash-strapped small businesses might use a line of credit to finance any and every purchase instead of using it for its true purpose: cash to get over the peaks and valleys of business. This is not money to buy new equipment with.

- Keep your credit reports clean, not only for your business accounts, but also your personal finances. Routinely examine your credit reports for mistakes. You have to have a clean record if you expect to get a business loan.

Banks care about very specific things, such as payments being made on time, the business staying within the loan's financial covenants, and the bank being sent the regular financial reports they want. That said, there are clear differences of approach to small business among the banks – some have a sharper focus on the needs of small business and offer a good range of tailored financial services.

A quick test could be to survey banks' web sites to get a feel for the level of interest they have in attracting small business accounts. (Most banks on their small business pages on their websites, might be a good place to start.)

Where to start

The early steps a business should take would include:

Tidy up the books: your clients should generate EBITDA, P&L, balance sheet and cash flow statements and isolate any one-off or extraordinary expenses. These financial reports are what a lender will use to assess if your client can repay funds borrowed.

Check bank statements: bank lenders look closely at these. Ideally, clients should have at least six months of minimal discretionary spending and be clear of negatives such as being overdrawn.

Show them their tax portal: a lender may check if the business is up-to-date with its tax obligations. A business with a clean tax portal report showing commitments are paid on time will have much more success getting funding than a business with a poor tax payment position. While the business may have entered a payment plan with the tax office to manage cash flow, lenders such as traditional banks may see this as the business being unable to meet its key obligations.

List financial commitments: a business owner having all their commitments in a simply outlined document can help with funding applications.

Capital: lenders look at borrower's financial position including assets and liabilities, net worth and liquidity.

Capacity: can the borrower repay over a suitable period? Lenders may calculate various ratios to show this, such as debt-to-income or servicing ratio incorporating cash flow, revenue, expenses and other outgoings.

Collateral: type of security (such as property/land/ accounts receivable) the business is providing, along with age, location and attributes of the security.

Character: what is the business and business owner's reputation (and credit history)? Lenders may consider factors such as loan repayment

history, general savings history, job tenure and credit ratings file.

Conditions: lenders look at how the borrower will use the money, trading ratios, whether they have security, plus external factors including state of the eco

Building Better Bank Relationships

To have a successful relationship with a bank, you should consider advising the SMB on implementing a bank strategy, including preparation of a budget and cash-flow forecast, which indicates a profitable business and the ability to repay the loan.

Prior to approaching the bank, it's a good idea to think about what the bank's questions are likely to be and formulate answers. Such questions might relate to previous discussions you've had with the bank.

Other potential questions for the SMB to consider may include:

- Are you running a profitable business?
- Do you have the cash-flow to repay the loan?
- What security are you offering?

To be able to convey to the bank that a business owner is operating a sound business, he (she) should be able to show the banker that you're doing your homework on your customers, that you have an appropriate debtors' management system, you might insure your debtors. Questions for the business owner to ask include:

- Do your staff have adequate training?
- Are they able to make day-to-day decisions?
- What is your relationship with the tax office? Are you in arrears or are you up to date with them?

It's also a good idea to find or build a 'cash-flow buffer' within your business, so that you're able to negotiate the difficult conditions that most businesses around Australia are in at present. Small business owners have to watch every penny they spend, however it is pointless to go seeking finance, if you are not suitable equipped.

What do bankers want to see?

Historical records:

a. Income Tax Returns (last three years)

b. Other returns (last three years)

c. Evidence that this was prepared independently (Tax Agent & BAS Agent)

d. Financial Statements (last three years)

And any third party records

How does a higher level report benefit a small business operator?

a. You will have a better chance of accessing bank finance.

b. You will get a third party assessment of the risk factors in the business.

c. You could save a lot of money by identifying unacceptable risks.

d. You could improve your business.

Like any good planning, don't go racing towards failure (rejection), invest the time and money into preparation. The returns will flow on and on.

Some key triggers for a business to seek funding:

• **Expansion:** growth creates the need for new equipment, inventory and staff, which can put pressure on cash flow

• **Turning away new business:** scaling up to meet the demands of a large customer or new opportunity can use up surplus cash

• **Current funding reaches limit:** they may not be aware of other sources of funds

• **Unable to meet commitments:** falling behind with the ATO or building up arrears with payroll and superannuation obligations

• **Slow paying debtors**

• **If they are having to dip into personal funds**

In many cases business owners might try to get funding, fail, then come to their accountant or broker concerned about cash flow.

Investing in new equipment

Different types of funding will be appropriate depending on their situation, stage in the business life-cycle and what is important to them at the time.

As an example, one of the main funding variables is the urgency of the need:

Short-term need: due to an unexpected situation such as:

• losing a major customer

• equipment failure

• to take advantage of an opportunity, for example, a large, one-off order.

When funding a short-term or urgent need, the business owner must weigh up the advantage of getting fast access to money against the fact this fast access may mean rates and fees are high. Many SMEs seek short-term funding when actually they would be better off with a longer-term solution, either debt or equity. Encourage them not to try solving ongoing needs using short-term solutions.

Funding needs change as a business evolves

Create a list of assets: many businesses feel they have nothing to use as security. However by listing every piece of equipment, tools and furniture (the ones they often forget to claim depreciation on), it all starts to add up.

It's OK to need funding: the right type of funding can make all the difference to business growth as it may be hard to just rely on sales to achieve success.

It's important for business owners to understand what type of finance is best for their stage of business (early, developing, mature, sophisticated), industry, business model or their need (short-term or ongoing) and what, if any, security they have to offer.

Some key criteria will help determine the best source of finance for your client. Use the following decision points to help them understand the need and find the appropriate solutions.

Ask your clients the *trigger questions below* to start a conversation (always a good opportunity to raise new revenue sources) about funding options, because often they don't know what to ask to get the information they need.

– Debt or equity?

– Secured or unsecured?

– Line of credit or fixed term loan?

– Banks or non-bank lenders?

Debt or equity?

Getting finance is often crucial for growth, not a sign of weakness for a business. One of the first decisions to make is around debt or equity. Make sure your clients understand the advantages and what to look out for with each option. Explain to your clients:

Borrowing is debt finance: money provided by an external lender, such as a bank, non-bank, SME specialist lender, building society or credit union.

Investment is equity finance: issuing shares for funds so others own a part of the business. Investors can be found through organisations or individuals such as angels, venture capitalists or colleagues, family and friends. To attract equity finance, a business must outline how any shareholder would be rewarded (dividends or distributions) and how their investment would grow and be realised.

Guarantees: a guarantee is not aligned to a specific asset, but signing a guarantee makes your client personally responsible for paying back the debt.

Line of credit or fixed term loan?

A line of credit: gives access to money, up to the credit limit set by the lender, when the business needs it and without them having to apply for another loan. Interest is paid only on the amount

accessed, not on the entire credit limit – but there may be a monthly usage fee. Interest is usually higher than for a term loan, to account for the loan's flexibility in providing the borrower with an on-call working capital facility to smooth cash flow issues or help when unforeseen business issues occur.

Traditional fixed term loans: usually put in place for a specific, planned purpose, such as making a worthwhile business purchase. To be approved for this loan type, a business needs good cash flow and a strong credit rating.

A fixed amount is borrowed and usually paid back monthly over a fixed term at a fixed or variable interest rate. Consistently making repayments on time and repaying the debt more quickly from surplus cash flow can improve a business' credit rating.

A bank loan can be secured or unsecured.

Bank overdraft

Special type of line of credit authorised by a bank and attached to the SME's transaction account. It allows the business to borrow up to a pre-set limit as they need it. Interest is charged on the amount of money used from the overdraft. May also involve fees and charges (sometimes there's a fee even if overdraft is not being used). Generally requires security of property or other business assets, or very strong financial performance. Suits businesses who are in and out of credit throughout the month

Business credit card

Allows a business to pay for large purchases and everyday expenses. Monthly principal and interest payments required. May include interest-free periods (generally up to 55 days). This can help cash flow management and improve efficiency. Transaction reporting can help a business track expenses and reconcile costs. Unless paid fully monthly, interest charges make this a more expensive funding option.

Equipment finance/leasing

Lender provides finance to help a business acquire equipment such as plant and machinery, computers, furniture or vehicles. The equipment, which serves as primary security for the facility, can be accessed straight away, with the lender setting a repayment schedule.

Can improve cash flow and inject working capital saving the SME from large upfront purchases to get vital equipment. Access to essential equipment or vehicles can facilitate new contracts and growth opportunities.

Select based on business needs

- Start-up – pre-trading but not yet profitable
- Growing - profitable or projected profits
- Established, stable business Established business with stressed requirements
- Start-up funding Launch new product/ expand territory/accept new opportunity
- Expand internationally
- Buy stock
- Invest in new equipment
- Refinance existing loans/reduce borrowing cost or
- consolidate
- Improve cash flow
- Pay tax/creditors
- Acquire another business
- Business credit card
- Equipment finance
- Export finance
- Floor-plan finance

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