FinancialDirector

In Your Business Series: The established business

Whether survival or business growth is on the agenda there are issues companies should mark, writes Gary Jesson, e-FM Network

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IN 2007, when the American subprime mortgage specialist, New Century Financial, filed for bankruptcy protection, cut staff numbers in half, and sold on its debts to other banks, the global banking industry began its gradual collapse. The situation led to reduced liquidity in the global financial system, making credit terms significantly harsher for UK companies.

Some companies are still recording major losses, redundancies have occurred albeit on a smaller scale than expected, banks have been taken over and those considered too much of an economic loss have been nationalised. SMEs, being more susceptible to changes in economic activity, have increasingly found themselves under tremendous pressure to do more with less, especially as a new business landscape evolves.

Despite this, some of the well-run astute businesses found the silver-lining in the dark cloud and have been thriving in the harsh climate and are in control of their destiny.

Finance Directors, fortunately, have the advantage of working with diverse companies to deliver specific results based on clear company goals, spot trends, and use them to build a system of controls and improved financial performance. As an FD, there are issues that in my experience, companies should mark for attention whether survival or business growth

is on the agenda, to ensure the company is better positioned to capitalise on market opportunities.

Financial health check: The periodic comprehensive review of a company's financial position is necessary to identify possible areas for growth and improvement. What you have always done in the past, you will find, will gradually lose its relevance. Financial considerations usually hinder many businesses from growing and so an opportunity to address any obstacles to growth, especially in today's climate is priceless.

Health checks are important not only in the event of an impending sale or change of ownership, they provide an indication of how healthy ANY business is and what changes can be made to improve processes, opportunities, profitability and cashflow. Find time to do it internally or externally, involve all to be effective. Most importantly, be thorough and have viable recommendations. Otherwise, what is the point of a diagnosis without a prescription?

Warning signs: Before a cashflow crisis hits, there would be red flags that may have been ignored or dealt with inefficiently. Every business needs to track and respond quickly to negative indicators.

Are there significant debtor balances aged beyond 90 days in your sales ledger?
Is your business on stop and do you have to purchase goods on a pro-forma basis?
Are you having difficulties in meeting your commitments to PAYE, NI and VAT with threats of fines and penalties?
Do you know which products and services make you money?
Are you getting pressure from your business bankers, factoring or finance house to restructure or reduce their facilities with you.
Do you have County Court Judgements (CCJs), any notice of impending legal action or complaints from suppliers over late payments and consequent breaches of business credit limits.
Are you out of cash even though your sales figures are increasing?
Are you working with the peaks and troughs of your business especially if it is in an established stage?
What have you done to address these issues and prevent a recurrence?

Generating cash internally and externally: Business secretary Vince Cable has recently announced that the government is to provide £110m in funding to peer-to-peer and alternative finance lenders in an attempt to boost lending to small firms. All sorts of new types of lending are appearing including crowdfunding, single invoice finance, pension fund loans etc. These alternatives to traditional funding are relatively easier to obtain than the conventional methods and are therefore more appealing to SMEs.

The purpose, time and cost of funds would usually determine the best funding option to consider. However, rather than be at the whim of external financiers or credit committees or even face the threat of extinction, management teams can strengthen their operational processes and financial controls to improve cashflow within the business.

Continuous monitoring: This is necessary in order to uncover any potential risk and compliance crises. Established businesses often become inefficient because poor "customs and practices" start to develop. Management teams need to focus on poorly implemented controls and weak policies and also test for inconsistencies or any possible collapse in financial controls. Operational procedures including credit control and expense claims processes need to be reviewed as well as any policy violations, missing data or documents.

Investment decisions: Creating a structure of a decision making process to represent the performance of an asset can help a company to forecast returns and make more informed decisions regarding a major investment. This mathematical model, when used is very valuable in guarding against risky decisions especially those concerning capital-intensive investments.

Reviewing contracts: What contract provisions and agreements exist between you and stakeholders including contractors, employees, investors and suppliers such as insurers and utility providers? What are the termination clauses? What is the length of each contract period and are there any clauses about automatic extensions with the caveat? What debt covenants have you negotiated? Watch out for deal busters. Don't keep old terms existing forever. Be a savvy negotiator and assess any advantage you could use as your bargaining chip?

Do not assume you do not have bargaining power. Is there any compensation for ineffective customer service? Does your provision include details about performance goals and targets linked to your compensation formula where possible? There are certain things not worth bickering about, pick your battles, but where it makes a difference, cut the best deal possible.

For this group, emphasis should be on maximizing profitability and productivity and remaining laser focused on the drivers of cash.

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REPLICATING business success is the dream of many entrepreneurs. For some others, driving sustainable growth through expansion can be a nightmare, as expansion can be

risky and in some cases, unsuccessful. Business owners often face a dilemma in deciding when the right time is to grow the business. Rapid expansion or attempted growth in the wrong market may be disastrous, causing huge losses, especially if the business is not financially strong. Expansion should often be avoided if a business is in trouble or not financially stable, as this will only magnify its problems.

A certain level of intuitive reasoning combined with strategic planning would be required for the analysis. Identify the inherent risks associated with the growth process in order to choose the right time, the right market and the right expansion route. In the case of mergers & acquisitions, it is important to be aware of the time and resource required to run the project - prior to, during and following the deal to enhance the chance of success.

Planning: Assess growth options based on your industry, availability of funding, the skills required, product and service offering. Also assess your goals and the possible risks of expansion. SMEs are usually more at a disadvantage because they lack the marketplace leverage that their larger counterparts enjoy by virtue of their size, but can often respond quicker to growth opportunities, as they would normally be more agile and quicker in decision-making when finding new markets to expand into.

Devise a business plan that is flexible enough to allow the business to capitalise on emerging opportunities. Establish a dedicated growth team with focus on a finance person who will be key in budgeting and projecting future cash flow, and will help understand the financial risks of the expansion strategy.

The Right Route: There are many options to consider - some of which include new physical locations, licensing, franchising, joint ventures, product diversification, globalisation and online growth. Do not underestimate the complexity of integration if you are considering collaborating. Likewise, when looking overseas, cultural fit and local law can have a significant impact on your planning. Some of the risks you may encounter during expansion include loss of key staff, incompatible technology, growing too soon and having to shut down some outlets/branches, funding crisis, and in the worst case scenario, losing your once profitable company.

Evaluate each route carefully and speak with appropriate advisers who have experience with similar businesses. Can you demonstrate proof of concept via a pilot, orders or signups for the new offering before the official launch date? This will validate your offering and its sustainability.

Organic Growing Pains: The greatest disservice any business owner can do is to grow too quickly and then subsequently collapse because the business is ill-equipped to handle new market demands. Incorporating contingencies into the business model will help in minimising to minimise some of the less palatable symptoms of change and reduce the risk of failure. Some of the problems that may occur during expansion include chronic understaffing or under-resourcing, high staff turnover resulting in low morale, system crashes, running out of cash or poor organisation due to increased responsibilities. To address some of these issues:

- Get flexible support until the job or role becomes clear and certain.
- Create systems and processes that are scalable and replicable. If you do invest in machinery and equipment, endeavour to use these assets to their full potential and focus on the aspects of your offering that advance your core competence and strategy. Delegate or outsource the rest.
- Do not lose sight of your strategy. Your business plan and budgets will keep you focused when demanding routine activities distract you and temporarily disturb your plans. Keep a core team of supporters and advisers to provide creative ideas, legal, financial and marketing support.
- Knowledge is power. Find out everything you possibly can. Background information will assist the business in leveraging the key steps for achieving a successful transaction, as either the purchaser or the target of a deal.

Mergers & Acquisitions: Many businesses would normally gravitate towards physical locations and new product development for growth, so it is important to focus on this delicate route here. Strategic mergers and acquisitions can be a quick and effective way to attract talent, market presence and income for a fast growing business. However, risks abound for the negligent. Management teams need to fully understand the mechanics of M&As to be effectively involved in the lead-up to, during and after the deal, transaction and integration stages.

Is there a cultural fit? Are there any skeletons in the closet? Are there any troubling press or integrity issues? Review every aspect of the business including the asset values (balance sheet), team quality, contractor and supplier agreement, liabilities, compliance, pay structures and contracts. Don't forget invisible items such as intellectual property, strength of customer, order book, websites and domain names.

For the strategy to work, effective communication is key as this it will facilitate integration and promote trust. Do not underestimate the time required to complete mergers and acquisitions- it could take up to a year. To minimise staff disruptions and deal with their fears, have clear organisational goals and share them to get cooperation and support. Bring in flexible additional resource to help over this period.

This is a very strategic route and should only be embarked upon with careful planning, research, support and advice. If this plan fails, what is your backup plan?
Obviously, there are inherent risks and these potential threats cause many businesses to choose to stay small. However, careful planning and precise execution will guarantee the success of any growth plan and help to optimise value, mitigate potential risks and implement the new business line effectively.

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