FEATURE

# Tough times ahead?

*by Terry Sofra, Shepparton, Victoria.*

TERRY IS A CHARTERED ACCOUNTANT AND FINANCIAL PLANNER. OVER THE PAST 20 YEARS TERRY HAS BEEN ACTIVELY INVOLVED IN THE FARMING SECTOR, STRATEGISING TO MINIMISE TAXATION AND ASSIST IN WEALTH CREATION.

## RECESSION PROOF YOUR BUSINESS

Just as evolution in animals dictates that only the fittest survive, in an economic downturn, it is survival of the smartest. Over the past six months the media has been all over the economic issues of inflation, rising oil and fuel prices, negative superannuation returns and a volatile share market. With all this negative economic sentiment, how do you recession proof your business?

Obviously there is no magic bullet but the clear message is it's time to spend more time working on your business and your accountant can play a key role in the process. In good times the weaknesses in your business can be concealed but when the going gets tough, the strengths and weaknesses will surface.

The best form of protection is early identification of the problems and accountants have access to some software tools that are designed to weed out the weaknesses and identify the warnings signs, on. Early detection lets you amend the strategic direction of the business and hopefully get back on track.

*There are a number of strategies I recommend to my small business clients looking to recession proof their business, which I have categorised below.*

## PLAN THE YEAR AHEAD

Historical data is important but you'll 'crash' the business if you drive it by just looking in the rear view mirror.

You can't change the past but decisions you make today will impact on your future results.

If you don't prepare an annual budget and have a plan in place you are asking for trouble when the economy turns. 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.

Cashflow is usually the most common client concern, the most visible and therefore the most painful. Helping a client identify all the activities that turn work into cash and then measuring those activities is very do-able and the results can be immediate.

Most importantly, a budget can identify if and when you expect to need additional finance. With financial institutions taking a tougher stance on credit, planning the timing and level of finance has never been more important. While generally we prepare budgets at the start of each financial year, your budget should be always be a work in progress under constant review.

## IMPROVE YOUR FINANCIAL RECORDS

In boom times business owners tend to not worry about the quality of their financial reporting system or financial management issues. Unfortunately when these bad habits spill over in to difficult economic times the problems surface.

Experience tells me that the majority of small business owners are using accounting software beyond their business needs and level of accounting skill. The net result is they generally produce 'computerised shoebox' records that are unsuitable for making critical business and strategic decisions.

So many small business owners get lost in all the figures, and can't see the trees for looking at the forest.

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 seven days of the end of each month because up-to-date, accurate records let you and your accountant make informed business decisions.

## MEASURE AND MONITOR TRENDS

The first casualty during a recession or downturn is usually income and it is important to identify the early warning signs. The first step is to review your revenue figures and compare them to last month, last quarter and the corresponding period last year so you can identify negative trends. Again, timely and quality financial data is essential. Some intelligent software we use can then evaluate the impact of the downturn in sales on the profit and cashflow of the business.

The challenge is then to develop a strategy to counter the decline but forewarned is forearmed.

For example, you may assess that the stocking levels are inappropriate or that you are holding excess replacement stock that is costing you money and aren't necessary. A careful review of which cows are productive may provide an opportunity to sell the less productive cattle.

No-one is immune so you need to closely monitor your main resources (land, livestock, equipment, labour) and ensure that everything is as productive as possible. Hard decisions now can avoid financial pressure later.

Carefully watch your debtors and make sure all your customers are paying within

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your credit terms. Early detection can be the difference between getting paid and having bad debts. Get statements out on time and keep in contact with problem accounts.

On the flip side you can put pressure on your suppliers to lower their prices and offer better payment terms. In business, if you don't ask you don't receive. Shop around for alternative suppliers of critical materials for your business to ensure you can complete your obligations in case a supplier ceases being able to supply.

## BENCHMARKING

Benchmarking the business' performance against the competition lets business owners know what is working and what needs working on.

It shows how the business stacks up against competitors and measures the business performance against the best and worst performers in their industry.

The financial data used in the benchmarking process includes performance indicators that largely centre on the profitability of the business. In the dairy industry they include 'return on equity' 'profit-to-revenue', gross profit margins and comparing wages to revenue and 'working capital ratio' profit. They provide a valuable insight into the performance of the business.

We also benchmark our clients against the industry statistics released by the tax office a number of years ago. We specifically look at gross profit margins, profitability and expenses as a percentage of revenue.

## ANALYTICS

Historically, business analysis used to be a marathon session between the business owner and their accountant with spreadsheets fanned out on a desk and both parties looking for processes and strategies to improve productivity and profits.

Business intelligence software has simplified the business advisory process.

Analysis software can provide clients with information to better manage their business and improve profitability, cashflow and overall business value. The process has been labelled 'analytics1' and accountants can highlight the financial impact of making some specific operational and financial changes in a business.

It's easy to say to a client: 'You need to grow 10 percent this year,' but what does that mean in real terms? How will that growth affect the need for capital? How will improving margins by 0.5 or 1 percent impact cash flows and profitability? What kind of cash flows are needed to accommodate the 10 percent growth?

You take the basic financials (balance sheet and profit and loss statement) and transform the numbers into meaningful and understandable graphs, commentary and ratios. We use analytical software to uncover profit enhancement opportunities with clients and the graphs and analysis form part of the regular client report that is in essence a 'financial health' check.

Analytical software is used to uncover profit-enhancement opportunities. Business owners are able to map out alternative scenarios to assist in making decisions that will maintain the viability of their business. Being able to understand the key drivers of your business profit, cashflow and value allows you to take decisive action.

## FINANCE OPTIONS - DEBT REDUCTION

Using your budget you can plan for the financial 'troughs'. You increase your chances of getting the funding you need, when you need it, if you plan ahead.

Too often business owners go to the bank for increased funding at the last minute. The enormous stress and panic of trying to obtain funding then can be so easily avoided.

In times of uncertainty and rising interest rates it is also time to review your business debt. What are the current lending arrangements? Are credit cards being used to provide a constant funding source as opposed to a more temporary option? Are you up to date with the Tax Office? A plan to consolidate debt then work out a debt reduction strategy can not only save thousands of dollars in interest but also ease cash outflows.

## ASSET PROTECTION

It is simply not possible to plan for every contingency or future changes in tax law.

Asset protection can be a trade-off between legal tax minimisation, and forward planning to take advantage capital gains tax concessions. It is imperative that you look at all your family and business assets and review who holds those assets and the potential risks that could mean the loss of those assets.

Businesses that have been trading successfully for years can be brought to their knees very quickly by a large debtor falling over. As a result of one or two significant bad debts, the Tax Office could be chasing you and the banks won't extend your credit. The assets that have been built up over many years, including your home, could be at risk.

Every business needs to be aware of where the potential risks are and then employ strategies to minimise the impact. This is crucial to protect your family assets from the 'Creditors and Predators'.

What assets have been used as security to obtain finance or rental agreements? Is the main asset used for business security your home? Can other assets be used to secure finance? Is there an opportunity to transfer assets to your spouse?

## WEALTH CREATION

After all the risks, long hours, and cashflow problems, what are you in business for?

Wealth creation is a significant factor for a lot of business owners.

Protecting your assets and putting strategies into place to grow your wealth is not just about making money. It's also about keeping it.

➢ **Superannuation -** How much can you afford to put into superannuation and are you taking full advantage of the recent tax law changes? Do you know where your superannuation is and how it is being invested and performing?

➢ **Property and Shares -** There are tax concessions associated with 'negative gearing' which allows you to claim the interest costs of purchasing and holding these assets. It has been a rough ride on the share market over the past 12 months, yet at these values one would expect a great opportunity for investing.

➢ **Tax Effective Investments -** This strategy is used to defer either income tax or capital gains tax to a later period when you better manage the tax consequences of the income. For example the sale of an investment to top up your super fund realises a capital gain. Tax effective investments can be used to defer the income to a period when you may be retired or not working so that lower tax rates can be applied to the income.

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## VISION

It is easy to adopt a negative approach in tough times. However, tough times present opportunities. Remember, when in charge ... lead.

Your bankers, employees, and family will get a great deal of comfort in knowing that there is a plan to get you out of the downturn. Try to be truthful about your situation, talk to as many professionals as you can but always make your own decision.

The first step taken in the right direction will give an overwhelming sense of control.

Also try to see the good in every bad situation. The current downturn will provide you with so many opportunities that would never be presented in the boom times. For example – you may be able to buy excellent cattle with quality breeding at reasonable prices or perhaps the neighbouring property may come up for sale.

Be ready to take advantage of opportunities that are only ever presented during downturns.

## ATTITUDE

They say the four people you hang around with will determine your success.

It is easy to get caught up in the negativity when the chips are down, but does it do you any good?

When I come across a couple of negative friends I usually leave them to talk each other's ear off.

If I'm serious about what I do, I need to be positive about the whole deal (or find something else to do). Usually if I feel a little flat I'II find a good book or tape to listen too or take a weekend away.

Do whatever it takes to give you that edge.

Remember you can't afford not to do it. ✤

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*Terry and his team are currently travelling regional Victoria to share tips and traps on 'Healthy Cashflow in Tough Times'.*
*Anyone interested should contact Terry's office - phone: 03 5831 3499*