BusinessPlus+ Newsletter

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What Does A Strong Business Balance Sheet Look Like And Why Is It Important?

Businesses with strong balance sheets are more likely to survive economic downturns and be ready to thrive when the going gets good again. Also the business will be in a much stronger position to negotiate cost effective and/or new funding facilities with its banker. So what does a strong balance sheet look like, and how can you take steps to strengthen yours?

A strong balance sheet goes beyond simply having more assets than liabilities. Entities with strong balance sheets are those which are structured to support the business goals and maximise financial performance.

Strong balance sheets will possess most of the following attributes: intelligent working capital, positive cash flow, a balanced capital structure, and income generating assets.

Let’s take a look at each feature in more detail.

1. Intelligent Working Capital

A strong balance sheet will provide an optimal level of working capital (current assets less current liabilities) to fund the core business operations, with the end goal of driving revenue and subsequently profit. It’s important that a business understands what that optimal level is. **The trick here is to strike a balance between liquidity and profitability which are often conflicting strategies.**

Having too much funds tied up in stock will strangle your cash flow and reduce your ability to meet financial obligations as they fall due. Having too much cash sitting in the bank could be coming at a massive opportunity cost to the business and be better utilised investing in higher income-generating assets, paying off debt or distributing to shareholders/beneficiaries. Too many business owners neglect to review their working capital requirements periodically.

2. Positive Cash Flow

Although this is a part of working capital it is so important to a business that it requires its own section. Cash, also referred to as ‘business oxygen’, is the most evidential sign of a strong balance sheet. Your business cannot breathe without cash flow. All businesses need cash to achieve their short term goals - to pay employees, trade payables and a host of other expenses. It’s therefore **vitally important to manage cash flow through forecasting, budgeting and the use of variance analysis.**

A sign that a business is doing well is one that regularly maintains a minimum cash reserve for rainy days/protection. A mix of historical analysis and future focus will assist your business in managing its cash flow and achieving its short term goals.

3. Balanced Capital Structure

A strong balance sheet will employ a balanced mix of debt and equity funding to maximise the return on capital employed. Debt in many cases is a cheaper source of financing – interest is deductible and shareholders often require a higher return on their investment. However, taking on debt always poses some risk – it can be rewarding when times are good but dangerous when there is a downturn.

Because of this risk, managing banking covenants becomes imperative. Equity financing can be more expensive but is considered less risky as there is no obligation to repay periodically. Entities with strong balance sheets retain enough earnings to fund growth and achieve business goals while distributing excess funds to shareholders. **Often strong balance sheets are the result of borrowing debt at a 'good' time**, (for example when interest rates are very low) for good investment purposes, for example improved manufacturing productivity. Of course, every business is different, and it's a good idea to seek expert financial advice before you make any long-term decisions. Balance is crucial.

4. Income generating Capital Assets

A business requires suitable capital assets to generate revenue, with some entities more capital intensive than others. **Management should invest in assets which will assist the business in achieving its financial goals.** These capital assets must be reviewed regularly, and if they are not performing then move them on and invest in those which are.

Strengthening your Balance Sheet

There are numerous reasons why a business might not have a strong balance sheet - poor financial performance, taking on unserviceable debt, stripping too much money out of the business… the list goes on. If you are the not so proud owner of a fragile balance sheet then you should engage a business advisor to get to the root of the problem before it's too late. A good advisor will do three things: identify the causes of the weak balance sheet, suggest processes and actions for improvements, and enforce accountability.

In the meantime, here are some tips on how you can improve your balance sheet:

- **Improve inventory management:** If you trade in goods, review your inventory levels immediately. If stock is obsolete, then shift it out the door – the cost of holding onto it could be more than you think.
- **Review your procurement strategy:** Do you have a purchasing schedule for the year, and is it being adhered to? Are you buying too late and missing out on seasonal sales? Make sure someone is responsible for this function of the business and plan, plan, plan - a forward focus is crucial.
- **Look at the collection of your receivables:** Are slow-paying debtors slowly strangling your business? You might need to implement a more aggressive collection strategy to ensure you get paid on time.
- **Sell lazy and unproductive assets:** If assets aren't generating a healthy return – and likely never will – then sell them on. Conducting financial ratio analysis is a great way to determine whether your business is using its assets effectively. You may want to look at leasing assets rather than purchasing them – this could be cheaper than owning, particularly for assets which date quickly such as those in the technology sector.
- **Maintain a forward focus:** Always ask yourself, what's around the corner? What are the threats to your current position? What strategic plans should you make for the future? Your balance sheet should reflect your business strategy.

Taking steps to strengthen and maintain a strong balance sheet will help your business thrive, even through the toughest of times; it also decreases the risk of failure.

Growing a business can be expensive, but a strong balance sheet will serve as a foundation from which you can launch into new products and markets. Not to mention bankers love nothing more than seeing a solid balance sheet with healthy cash reserves and a balanced capital structure when assessing loan applications.

Overall, a strong balance sheet will make your business more agile and give you options to shape a more profitable future. You can learn valuable lessons about your business from your financial information - you just need to know how to read it. CBSW have a two day workshop for business owners that will help them learn how to draw valuable insights from their financial statements to increase business growth and make the business more valuable. **If you are interested in finding out more about this workshop please contact Lyall Bear at our office.**

Business Needs Review – Part 7 – Risk Management

Risk management is so important for peace of mind in a business, if appropriate policies, cover and agreements are put in place, in a world where litigation has become more prevalent. Having appropriate risk management documentation and agreements in place is critical and generally not well handled by many SME's in our experience.

So please consider all of the questions listed below with an open mind as to how they might impact on your business and family and what action you may need to take to ensure you are best placed if an event arises.

1. ***What would happen to your family and business if you passed away?***
2. ***What would happen to your family and business if you were incapacitated or you got sick for a significant period of time?***
3. ***How does your current will meet your objectives if you passed away?***
4. ***Do you have an estate plan in place and is there sufficient protection for beneficiaries – please describe?***
5. ***What concerns do you have regarding your fellow partners/directors and or shareholders?***
6. ***How do your partnership/shareholder agreements ensure that your objectives are met if you passed away or became incapacitated or had an issue with your fellow partners and or shareholders?***
7. ***How is business valuation built into these documents? If not do you believe this is a critical step forward?***
8. ***Can you describe what 'cross cover' insurances that you currently have and their sufficiency to meet anticipated risks?***
9. ***Will your other insurances manage current and future risks – how so?***
10. ***What are your three biggest business risks and how do you plan to manage them?***

If you need assistance in any of these areas of your business, please contact Lyall Bear our Business Advisory consultant.

Properly Defining Your Business Problems/Issues

Typically when we ask a business owner what problem they're trying to solve, they'll instead express an outcome or output – such as "We want to increase sales revenue by 20%", or "We need a marketing campaign".

But here's a fact that's as useful as it is simple: **the starting point for effective agile strategy-making is having a <u>meaningful problem</u> to solve.**

Yes, a 20% lift in sales revenue does solve a business problem – if the current level of revenue is creating one.

Likewise, a marketing campaign can be an effective way to solve a business problem, but it's a waste of precious resource if the problem it's designed to solve isn't meaningful.

When "strategy" is not actually strategy

A lift in sales isn't a strategy, it's a goal.

A marketing campaign is neither a strategy nor a goal, it's a tactic. Since strategy sits between goals and tactics we can describe it as the intelligent design of tactics to give an organisation its best chance of achieving its goals. **A strategy is agile if it:**

- **Focuses on solving problems that are real and meaningful** in the sense that they represent a quantifiable impediment to success.
- **Defines the smartest possible way forward** – that is, the least investment for the greatest return, based on everything that's knowable now (because let's face it: so much isn't).
- **Continues to evolve, based on reliable feedback and data,** and therefore remains relevant and applicable.

You might think the most difficult of these three to get right, would be defining the smartest way forward, and yet usually **the greatest struggle is people's ability to articulate the problems the organisation is working to solve.**

Seriously, ask yourself this question right now: **"What are the most meaningful business problems my key people are focused on solving?"**

Give yourself a pat on the back if you answered it accurately and correctly without asking any of them. If you didn't, let's talk about why this 'describing problems' thing is so much more difficult than you'd logically expect. There's some good science around ***our capacity to deny fact*** and a related propensity for "motivated reasoning"— believing what we want to believe.

There is discomforting amount of old-school business-cultural thinking that contributes to this phenomenon. Thinking like:

- Talking about problems makes them worse
- The presence of problems implies failure
- Talking about problems is just being negative.

Yet we all know that the first step in solving any problem is acknowledging that it exists.

So, it really is this simple: **if you want your strategy to actually be strategic, get better at ferreting out and defining the problems that are limiting your business's success. I**f you want it to be agile – and you know you do – go positively enquiring more regularly, more courageously, and with more inputs from your internal and external feedback and data sources.

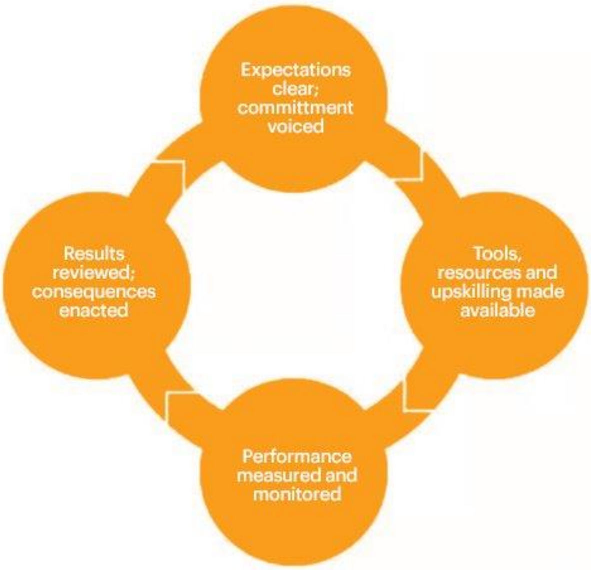
Lyall Bear our Business Advisory consultant for CBSW can assist you either one on one with developing your business strategy or you could attend our Business Strategy Workshop. Please contact if you have an interest in either of these options, which will make a positive difference to you and your business.

Three Ways To Put The 'Performance' Into Your Business Culture

Strategy is useful when it's contained in a tight feedback loop. In that loop: execution is made visible; meaningful results are monitored and scrutinised; learnings are collected and integrated into strategy-making for the next iteration.

A single issue that perplexes virtually every organisation it is performance accountability- or more specifically, it's their ongoing struggle with making accountability stick. If this resonates with you and your business, then let's introduce some simple management thinking that could revolutionise your workplace and your performance results.

1. Meet the Accountability-Trust loop:



It's designed on the basis that accountability can't exist without trust, which can't exist without accountability. So there's an invisible condition for the loop to function, which – ironically! – is transparency. Expectations must be transparent. Gaps in capability must be transparent. Performance and results must be transparent, and likewise the review process.

Like all good management models, it's very simple. Yet if you instil it into the heart of your organisational culture you'll observe a huge change in the performance of individual employees and teams that can quickly translate into a huge competitive advantage.

2. Management Approach and Accountability

This concept is nicely summarised in the diagram below:-

Management with "Eyes on" and "Hands-off" is a good and concise way to encapsulate the transparency that a trust-accountability loop relies on.

3. Accountability is crucial:

"Silence is disagreement" — if your team isn't voicing agreement, don't just assume they agree. Rather, assume that they don't and, if their agreement is necessary, flush out any issues that require resolution.

"Disagree and commit" – commitment is a fundamental requirement for accountability. There will always situations in which it's impossible to gain absolute consensus, but these can't be allowed to derail your progress. In those situations, it's reasonable and necessary to ask for every team member's commitment, and for them to apply themselves to a solution as though it was their own idea.

Accountability is so important to effective Strategy implementation because:

- Strategy fails if it doesn't take into account the real situation in your business;
- Strategy fails if there's no feedback loop connecting plans, actions and results;
- Strategy fails if teams don't genuinely buy in to – or at least genuinely commit to – its implementation;
- Strategy fails if the people responsible for its implementation aren't held accountable for the effectiveness of that implementation.

We all know about the best-laid plans of mice and men. The tactics you meticulously planned, when deployed in the real and bloody world of modern commerce, won't work as brilliantly as you'd hoped.

But since that equally goes for your competitors too, it's all the more reason to stay agile, **follow the feedback loop, and maintain accountability for the effectiveness of your strategy-making and its execution.**

Crowd Sourced Funding Amendments Passed

The Senate passed the Corporations Amendment (Crowd Sourced Funding for Proprietary Companies) Bill 2017 on 12th September 2018. The legislation will be operational 28 days after Royal Assent. This means the legislation will be operational from approximately 15th October 2018.

The legislation withdraws the requirements in the original legislation that a private company had to convert to an unlisted public company to be able to raise capital from the public.

The main features of the legislation are:

- Private companies with less than $25 million in consolidated assets and annual revenue that have their principal place of business and a majority of directors in Australia are eligible to participate in the CSF regime.
- Eligible companies can raise up to $5 million in any 12-month period.
- Retail investors have an investment limit of $10,000 per company in any 12-month period.
- CSF offer can only be made via a licensed CSF Intermediary's platform.
- Companies making CSF offer must prepare a CSF offer document which includes prescribed minimum information.
- For a private company to participate in the CSF regime, the proprietary company must have at least 2 directors, and either one director (where there is only 2 directors) or a majority of directors must ordinarily reside in Australia.
- A proprietary company, which raises capital as a Crowd Sourced Funding Company, will have up to 3 groups of shareholders:
  - Private company shareholders which are limited to 50 non-employee shareholders.
  - There is no limit to the number of employee shareholders that the company can have.
  - There is no limit to the number of CSF shareholders that the company can have.
- CSF company has to prepare annual reports and director reports.
- Proprietary companies, with more than $3 million in CSF capital, will need to be audited.
- CSF company has to notify ASIC when any CSF shares are issued.

If you would like to have a discussion with us relative to the new legislation for Crowd Sourced Funding Equity Raising for private companies, please do not hesitate to contact us.

A Positive Culture Is Vital!

If you want your company to be successful, directors have to embrace the development of a "positive culture".

A director's first priority is the appointment of a Chief Executive Officer (CEO) – the second priority is to ensure that a "positive culture" has been implemented within the company/business.

Where to start on the implementation of a "positive culture"?

Companies need to appoint a CEO who will then appoint a strong management team.

Company directors need to ensure that appropriate systems have been implemented so that management will be receiving information that they can use to manage the business. Directors will be able to review the systems to ensure that everything is functioning satisfactorily in the company.

The systems the company should be considering implementing include:

- Business Management Systems - appropriate for the type of business that the company's operating e.g. retail systems, tradie business systems, manufacturing business systems.
- Financial Management System - appropriate for the company's business operations.
- People Management - this is very important, because there are some aspects of people management for which directors can be personally liable.
- Marketing and Brand Management - is this being handled appropriately?
- Pricing - are products/services being priced according to the methodologies implemented for the company?
- Team Members' Skills Improvement - Is the system being implemented? Is there evidence that the team is working together relative to brand development and marketing?
- Management Team - directors need to monitor the performance of the Chief Executive Officer and the senior management team to ensure that:
  - there is a focus on the development of the "culture" within the company
  - "core values" have been identified and have been communicated to the management team and the other team members in particular identifying – what is acceptable – what is not acceptable.

How is the company performing against the strategy that has been set?

Directors should be satisfied that the structure of meetings within the company will contribute to the "company organisation culture".

Directors should enquire as to what has happened relative to skills development of the total team within the company.

Core Value Statement

Key components of a "Core Value Statement" include:

- commitment to teamwork within the company
- integrity within the company
- pursuit of a high level of excellence
- a high level of professionalism in the company
- commitment to innovation within the company

Many commentators believe it is vital that the management team develop a "story" around each of these "core value items" and that these "core values" are communicated to all team members and openly discussed in team interviews, induction of new team members and performance appraisals.

Many successful companies have indicated that implementing these strategies and the identification of various processes all contributed to the creation of a "positive culture" within the company.

If you would like to talk to us about a conducting culture review within your company, please contact Lyall Bear our Business Advisory consultant at CBSW.

Self-Rating For Business Start-Up

If you are considering starting a small business, you have to be honest with yourself and understand your strengths and weaknesses. Unfortunately, well over 60% of businesses do not survive for more than 2 years.

In various surveys the following reasons for failure have been identified:

- failure to manage costs/anticipate rising costs
- inexperienced management
- no business plan
- insufficient capital or adequate access to borrowings
- poor marketing
- insufficient understanding of "social media"
- too much expansion, too quickly
- not enough time devoted to managing the financial records of the business
- not being able to read financial accounts
- failure to seek professional advice – every business needs a proactive accountant that is being communicated with on a regular basis throughout the year so that matters of concern can be discussed and clarified e.g. at least monthly.
- failure to prepare a budget

You need to consider these items as well as the following:

- How do you get on with other people? – Because in business you will be dealing with all types of business personalities – can you handle that?
- Can you handle failure? – Because in a business you will encounter a significant number of "failures".
- Can you set clear goals and then work towards achieving them?
- Can you "sell products/services"? If not, before starting a business, it might be advisable to undertake a "selling course".
- Do you have drive and energy? – Are you prepared to work the extra hours that most businesses will require you to undertake, if the business is going to be successful?
- Do you have self-confidence?
- Are you prepared to continue to learn? – Businesses change every day, the marketplace can change every day, businesses require you to be flexible and definitely require you to commit to an on-going learning process, whether it's technology, marketing and selling tactics, new products and processes, continually refreshing you and your team's knowledge on business matters.

When you have considered these items, we suggest that you prepare a SWOT Analysis (Strengths, Weaknesses, Opportunities and Threats) on yourself as a business operator.

When you have completed this self-evaluation, if you still want to proceed with a business opportunity, we suggest that you make an appointment to have a discussion with us, so we can give you an overview of the types of services that we believe you will require for you to operate a very successful business.

Export Market Development Grant

The Export Market Development Grant aims to assist the development of exports by Australian firms. The grant provides financial incentives in the form of taxable grants, based on eligible expenditure, to promote exports. An applicant's maximum turnover worldwide has to be under $50 million. The grant focuses on direct promotional activities and does not assist the general establishment of a business or product development. The Export Market Development Grant is administered by Austrade. The Export Market Development Grant reimburses up to 50% of eligible export promotional expenditure, provided that the total expenses are, at least, $15,000 in the year.

Eligible expenditure which can be claimed (subject to some category limits and an overall maximum grant of $150,000 per annum) include:

- Overseas representation – all reasonable costs that you paid to have an overseas representative act on your behalf to monitor and promote your product – subject to a maximum of $200,000 per application claimable under this category.
- Marketing consultants – professional fees for the engagement of short-term market development consultants – subject to a maximum claim of $50,000 per application under this category.
- Overseas marketing trips taken to seek out potential export markets to promote your product to increase export sales. Expenditure relates to:
    - airfares outside Australia (only 65% of 1st class airfare may be claimed as an eligible Export Market Development Grant expenditure)
- Free samples – all reasonable expenses incurred to provide a free sample outside of Australia to a non-Australian resident.
- Free tourism samples – if you are an inbound tour operator who buys tourism amenities from other Australian tourism providers, you may claim the costs you paid for the amenities.
- Trade fairs and promotion events – directly related costs to participate in an international trade fair, seminar, in-store promotion, international forum, private exhibition or similar activity.
- Promotional, literature and advertising – for brochures, flyers, billboard advertising.
- Overseas buyers – bringing an overseas buyer to Australia who has the influence to purchase, or potentially purchase, your products and who travels to Australia in order to view, evaluate or have your products demonstrated to them.

This category is capped at $45,000 per application, subject to a sub-limit of $7,500 for bringing an individual person to Australia. If you require any assistance on determining your business' eligibility for an Export Market Development Grant, please do not hesitate to contact us.

The closing date for the lodgement of Export Market Development Grant applications, in respect of the year ended 30th June 2018, is 30th November 2018.

If you would like to discuss with us the preparation of an Export Market Development Grant application for your business for 2017/18, could you please contact us at your earliest convenience.

Director Penalty Notices

Changes coming to the Director Penalty Notice regime.

The most dreaded weapon in the arsenal of the Australian Taxation Office (ATO) is the "Director Penalty Notice" (DPN) and its powers are being broadened and expanded to increase the liabilities for all directors.

A DPN is a notice that the ATO can send to a director or directors which will make that director(s) personally liable for the unpaid PAYG Withholding and the Superannuation Guarantee Charge (SGC) liabilities.

A company director becomes liable to a penalty at the end of the day the company is due to meet its obligation, at this time the penalty is created automatically, however, the ATO cannot commence any recovery for these liabilities until 21 days after a penalty notice is issued to a director.

There are two types of DPNs:

- 21 Day DPN – 21-day DPNs are issued to company directors who have lodged BAS, IAS and SGC statements within three months of the due date for lodgement, but the PAYG withholding and SGC remains unpaid.
  If the company has all the lodgements completed on time, the issuing of a DPN allows the directors 21 days to make payment which results in the penalty being remitted.
- Lockdown DPN – a lockdown DPN is issued where a company has failed to lodge its BAS, IAS or SGC Statements within the three months' time frame. If this occurs, the penalty permanently remains with the director and there is no ability to remit the penalty, other than by paying the debt.

Lodgements should be made on Time

All companies need to ensure all their lodgements occur on time. The use of a tax agent allows for an additional period of time of four weeks, for these lodgements, which gives business owners an extra reason to pay for a tax agent's help with lodgements. The simple fact is, the DPN regime punishes those who are unorganised and do not meet lodgement requirements.

Further Changes Proposed

The changes announced in the 2018/19 Federal Budget included that the government is proposing to include the GST as an additional liability that directors will incur in the DPN regime. This is not law as yet but will change in the future.

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