BusinessPlus+ Newsletter

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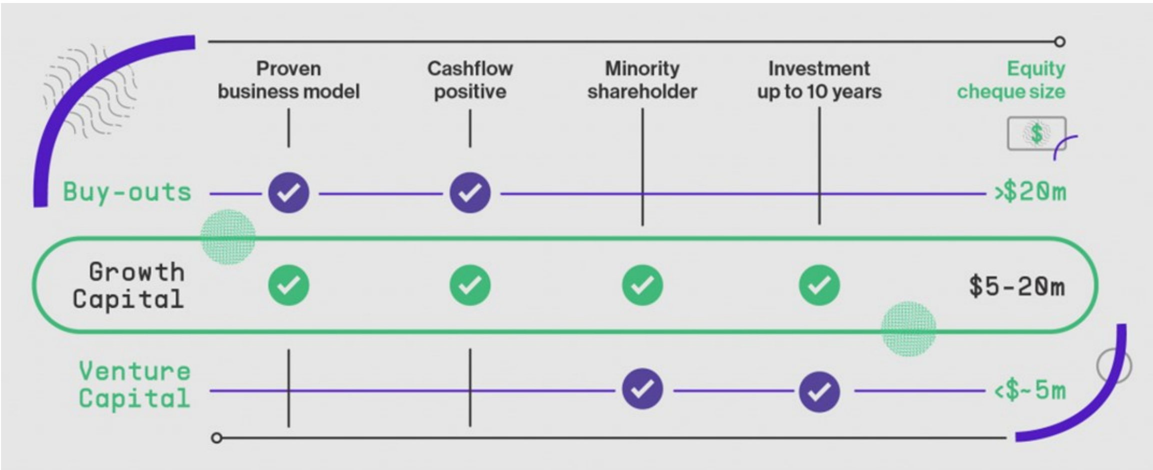
Looking for an External Business Investor? - Part 2

This article was adapted from information provided on the ABGF website.

The first part of this topic was included in the December 2022 edition of our BusinessPlus Newsletter. We started to explore some of the options available to SME business for funding their business growth initiatives and ambitions as shown in the diagram below. We were looking at the Australian Business Growth Fund ("ABGF") that quite recently has provided some new options for business.



Three 'Sights' of the Right Business Strategy

The last 18 months have been incredibly challenging for SMEs. Facing uncertainty and disruptions on all fronts, many business owners feel more like firefighters than entrepreneurs; they barely have time to look up and out from the day-to-day grind.

With that in mind, we stress the importance of having a planned and documented business strategy and the long-term benefits that come with being able to work 'on' a business, instead of just 'in' it.

A robust strategy is an essential ingredient to business success – especially through periods of upheaval. For instance, an annual survey by CPA Australia found that businesses that grew strongly in 2020 were much more likely to prioritise their business strategy compared to businesses that didn't grow. Unfortunately, many businesses still often lapse into ad-hoc and reactionary decision-making.

A business strategy is a bit like an extra set of eyes – it allows you to see your business and the road ahead more clearly – or from a different perspective entirely.

In fact, a great strategy gives business leaders 'sight' in three ways…

Hindsight - Reflecting on what's been done and looking at new opportunities and threats

Business leaders need to stay focused on their long-term goals, but this requires self-reflection and awareness on whether your current path is moving you toward those goals. Setting (or revisiting) your strategy helps you zero in on what really matters to your business. It's easy to become distracted by the minutiae of your daily, monthly, or even yearly targets – you may find you've steered off course chasing a small win that won't deliver the level of growth you're seeking.

Some say hindsight is 20/20. Taking a step back to reflect on how you've flourished – or faltered – in the past can help you contextualise new challenges and opportunities that arise along the way – so you never miss the chance for a step-change in growth.

Insight - Helping see where your business or products are heading

Growing businesses should always be advancing their pipeline of new products, services, and features. A strong strategy prompts you to leverage the right insights to evaluate where you stand and adjust your product plans accordingly.

Data is critical in enabling businesses to take decisive and impactful action but there are plenty of pitfalls as well. Data can be a distraction – especially if its unstructured or captured without clear goals in mind.

Similarly, many businesses are so focused on using data to 'disrupt from with' – they end up pursuing a dead end or making dramatic changes too quickly. While innovation is critical, abrupt change can alienate existing customers – especially in established businesses. Are you headed toward insight-driven innovation or a data-fuelled distraction? Your customers are typically your best barometer on your evolution. Focus on using targeted data insights to respond to their needs and to bring them along the journey.

Foresight - Strategy helps you keep an eye on the future

Pandemics aside, the most disruptive challenges to your business won't happen overnight. Like a tectonic plate, there is constant change beneath the surface that slowly, but surely, builds toward a tumultuous shift. A strategy that looks at least three to five years ahead helps you keep an eye on how these trends are progressing, which in turn, gives you the chance to prepare.

The consequences resulting from macro trends such as climate change, decarbonisation, digitisation, and an ageing population all have the potential to derail unprepared businesses. While you won't have all the answers as to how you'll navigate these trends, you won't be able to respond effectively without a plan.

Strategic foresight is especially critical because parties looking to invest in the future of your business are already looking 5 to 10 years ahead. They won't want to invest in a business that has its head in the sand.

Have a One-Page Business Strategy

Despite adding immense value to you and your business, your strategy doesn't have to be complicated. It can fit on a single page. **At its simplest, an effective strategy typically covers your financial goals, your product goals, and channels, as well as the implications of those goals on your organisational structure and capital needs. Your strategy should not be static – it's strengthened by regular feedback and revisions.**

Usually, it's easiest to start with the end goal in mind. Ask yourself, *'Where do I want my business to be in five years' time?'* Then, work backwards from your preferred financial targets.

Identify your total addressable market, the market growth rate, your current market share, and the slice you would need to reach to achieve your financial goal. This exercise allows you to sense check your goals as you might need to expand your target market or change your product plan to achieve them. Once they align, you can begin clarifying and challenging your assumptions and validate further with trusted advisors.

From there, your strategy builds with a logical cascade of assumptions. What product roadmap is required to achieve your target market share? This plan influences your product development, channel, and potential acquisition strategies, which in turn, influences your organisational structure and the level of resources dedicated to each work stream.

Understanding what resources you will most likely need to succeed dictates your predicted cash flow position and will get you thinking about how you'll finance your growth plans.

Take Control of Your Business Cash Flow

Cashflow issues are never far from business owners' minds. Typically, issues manifest in the form of a cash crunch – a period in which there's simply not enough cash to cover your operational needs.

A report by Money.com.au found that even before the impact of COVID, more than half of business owners had foregone or delayed paying themselves an income due to cash flow issues. Despite cash flow issues being one of the most talked about topics within the SME community, it remains one of the most misunderstood. Businesses run into cash flow problems for a wide variety of reasons – and often, it's not because they're unprofitable or underperforming.

Cashflow crises often occur during periods of significant growth. It's how business owners' rise to the challenge that determines how far they can potentially grow into the future.

Resetting Cashflow Understanding

One of the biggest misconceptions about cash flow is that it's a static number – cash at bank. When asked about their cash flow, many business owners respond with how much money they have in the bank at that moment, instead of communicating how money moves in and out of their business over time, seasonality, and growth impacts.

Another common misconception is equating cash flow with profit. Many believe if they maintain profitability, they'll avoid cash flow issues. But the reality is that highly profitable businesses run into cash flow issues too, especially if they're growing too quickly to keep pace with their working capital requirements.

Mastering your cash flow means having a complete picture of the timing and magnitude of the business's working capital requirements, whether you have sufficient funds to meet all your obligations, and how you plan to finance future challenges and opportunities.

Over time, businesses that don't effectively manage their cash flow, end up operating in a reactive manner. Cash crunches limit your ability to step back and take a long-term view of the business. It's challenging to focus on strategic initiatives and investing in the future when your time and energy is spent on putting out fires and worrying about upcoming payment obligations.

The best way to avoid cash flow issues: strengthen internal control and planning functions and identify suitable sources of capital early.

It's common for small businesses to outsource parts of their finance function – most often payroll and accounting. But where many growing businesses go wrong is failing to strengthen their in-house financial control and planning capabilities early enough in their journey. As a result, they lack strategic oversight of their finances at critical moments.

Ideally, having a skilled finance team in-house is important to ensuring good financial management, control, and planning. A capable financial controller or part-time CFO can help you implement better controls over cash flow and put the potential cash flow implications of the business's longer term and strategic projects into context.

While it's not critical for business owners to understand the fine details of financial management and accounting, it is important to have your finger on the financial pulse of the business. Ensure there is in-house capability for financial control and management and rely on your CFO/Financial controller/Accountant to provide you with key information and regular reports that enable your understanding of how business performance is tracking against targets.

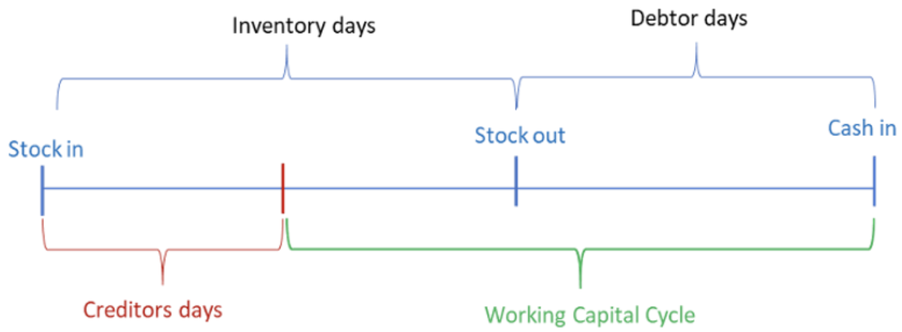
Poor cash flow could also be indicative of poor capitalisation of a business. This is especially true for fast growth businesses with growing working capital requirements. It's prudent to plan early and identify various sources of capital (equity, short- and long-term debt, etc.) that best meet the business needs, and the owners' preferences.

Metrics to Manage Cash Flow

For business owners looking to get a better grasp on the numbers and the financial health of their business, these three key metrics are a good place to start.

Working Capital Cycle: When evaluating the financial health of a business, investors seek to understand its 'working capital cycle'. This cycle is made up of three parts, as shown in the diagram below.

Inventory days - How long the company sits on its inventory.
Debtor days - How long it takes the company to collect cash from its customers.
Creditor days - How long the company takes to pay for goods and services it receives from suppliers.



Your working capital cycle is a simple equation: (Inventory days + debtor days) – (creditor days)

Working out the difference between the sum of your Inventory and Debtor days and your Creditor Days reveals the gap between cash leaving and coming into the business. A large gap, or a working capital cycle that is increasing over time, may indicate a cash flow crisis on the horizon.

Free Cash Flow (FCF)

A key metric in assessing your business's financial performance is the business's ability to generate Free Cash Flow (FCF). FCF is the cash that the business generates from its operating activities, after considering capital expenditures (CAPEX). This measure identifies your business's ability to generate positive cash flow from its products and services and helps you understand its true profitability.

FCF = Operating Cash Flow – Capital Expenditures

If money is tied up in outstanding accounts receivable, overstocked inventory, or high CAPEX, you might run into liquidity issues, even if you're generating large profits.

Debt Service Coverage Ratio (DSCR)

Another useful metric to consider is your business's debt service coverage ratio (DSCR). DSCR is a measure of the business's ability to meet its short-term debt obligations. The ratio shows the company's earnings as a multiple of its debt obligations due within one year.

DSCR = Net Operating Income / Short-Term Debt Obligations
(also referred to as "Debt Service")

A DSCR of less than 1 means a business might not be able to cover its debt obligations without additional sources capital injection (equity/debt).

Cash flow issues can stop a profitable, growing business in its tracks and impact its future longevity and prosperity. But with accurate financial information, planning and support, the business owners can take control of the business's financial future.

Additional Resources

To be eligible to apply for funding from the Australian Business Growth Fund, a business will need to satisfy the following criteria:

- An Australian based headquarters
- Business turnover between $2M and $100M per annum
- At least three consecutive years of continuously profitable historical trading operations
- Have a clear and documented business growth strategy.
- More information is available at **abgf.com.au**.

Of course, a business should, in the first instance, usually pursue growth funding from its existing bankers. The following information may be of assistance when assessing your business financial position and for strategic planning:

- ***Essential Guide to Business Funding* – HERE**
- At - ***business.gov.au/grants-and-programs***
- ***"The Essential Guide to Strategic Planning, Budgeting and Forecasting"* – Executive Summary – HERE**
- ***A West Australian Consultant, for Grant, Tender and Business Case application assistance – at Whitney Consulting - whitneyconsulting.com.au***

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