



ARTICLE

Financial Management Tools that can Help Your Business Succeed

Why Do Businesses Fail?

It's a well known fact that most new small businesses fail within the first five years. The reasons for failure vary, but inadequate management skills and poor or uninformed decisions are often the cause. What distinguishes a viable business opportunity that succeeds from one that fails can often come down to:

- The quality of planning in the concept phase, and
- The quality of ongoing financial management once the business is established

A quality business plan and an effective financial management framework are vital in equipping business owners with the information necessary to make the right decisions for their business.

Business Plan

A business plan formally documents the business concept, its viability and the roadmap for establishing and running the business. It has no fixed content, rather the content is tailored to suit each business proposal and audience. A typical business plan might include the following:

- Executive summary
- Business description
- Business environment analysis
- Industry background
- Competitor analysis
- Marketing analysis
- Marketing plan

- Operations plan
- Financial plan
- Management summary
- Milestones

Lack of a quality business plan puts start-up capital and any ongoing financial support at risk on a number of levels. A substandard business plan may reach an incorrect conclusion as to business viability therefore business failure may be inevitable. Lack of a defined and cost-efficient approach to establishing and running the business is likely to dilute precious business profits in the start-up phase and beyond. Therefore, a quality business plan is the best safeguard against the often significant investment exposed to financial risk in new business ventures.

Financial Management

Business managers are charged with the responsibility of maximising the financial health of their businesses therefore a quality financial management framework is of paramount importance. If business conditions were static, there would be no need for a forward thinking approach to financial management as current performance would mirror future performance. Business conditions are of course not static, therefore financial management must go beyond simply measuring current performance. A framework is required that provides the information necessary to make informed decisions in response to changing business conditions. This framework should allow business owners to not only track historical

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results, but look ahead and project future performance based on an analysis of current performance and forecasted market / economic conditions generally. In short, the framework should minimise the “surprise factor” in managing the performance of a business.

Without this, business owners cannot quantify the impacts of emerging trends, opportunities, threats and changes generally to their business.

There are a variety of established financial management tools and processes that can assist in creating an effective financial management framework, such as:

- Preparing Budgets
- Preparing Cash Flow Projections
- Comparing Actual with Budgeted Performance
- Benchmarking Performance
- Stress-Testing Projections

These are discussed briefly below.

Budgets

A budget is a projection of income and expenses over a specified future period. Budgets assist in determining financial viability of new businesses and confirming the ongoing financial viability of existing businesses. They also serve as a useful reference point for tracking actual versus expected performance. If preparing a budget for an established business, a good starting point is current performance. This data can then be adjusted for assumptions about future business conditions such as increased market share and shifts in costs etc. If preparing a budget for a new business, detailed knowledge of the industry and recent profit / loss data from a similar business is a useful starting point.

Assumptions are critical to budget outcomes and common errors in the budgetary process include being unrealistic about both future business conditions and expectations of how the business will perform. Therefore, business conditions need to be keenly assessed and any assumptions made regarding future performance should be complete and realistic. Preparing a set of budget reports canvassing the best case, worst case and most likely scenarios is an effective approach to budgeting as it provides a range within which to gauge business performance.

Cash Flow Projections

A budget on its own does not present a complete health check of a business' potential performance. A business may be profitable yet have serious cash flow problems for a variety of reasons. A cash flow projection is a necessary part of the suite of financial tools that can assist in effectively managing the financial health of a business.

A cash flow projection is a projection of available operating cash surplus (or deficit) over a specified future period. These are normally prepared with reference to a budget covering the same period and any other inflows and outflows that are expected. For new businesses, this is a particularly important tool as there are often significant start-up cash outflows that are not necessarily evidenced in a budget. Therefore, an immediate benefit of preparing a cash flow projection for a new business is determining:

- The amount of start-up capital required, and
- Any ongoing financial support required until the business becomes financially self-sufficient

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For both new and established businesses, it is a useful tool which can anticipate future cash surpluses or deficits. This can assist with:

- Planning for lumpy cash outflows such as tax payments and lease balloon payments
- Planning for any finance buffer required such as an overdraft or line of credit in order to absorb the time lag impact of any lumpy cash inflows or outflows
- Determining whether debtor and / or creditor collection terms need to be revisited in order to better sustain business liquidity
- Determining a point in time when the business can afford significant capital investment funded entirely by business profits

Without cash flow projections, business owners cannot foresee possible liquidity issues, whether it be a cash deficit on one hand or significant levels of uninvested cash on the other. As with budgets, assumptions are critical to projecting cash flow and it is vital that assumptions are realistic. Common causes of inaccurate cash flow forecasting include unrealistic assumptions about debtor collection and creditor payment timeframes, and neglecting to include all revenue and capital inflows and outflows in the projections.

Comparing Actual and Expected Performance

Financial management should not be just about creating numbers, but analysing those numbers. Comparing actual with expected performance is one such analytic tool and this is critical in determining why a business may not be performing in accordance with

expectation. It can also serve to point out where assumptions on future performance have been inaccurate. Therefore, this sort of analysis also equips a business owner with information that assists in accurate forecasting going forward.

Benchmarking

Benchmarking is another useful analytical tool where actual business results are compared with the actual results of similar businesses. This of course relies on competitor information being available, but the aim is to provide a gauge for how successful a business is within its industry.

Stress-Testing

Stress-testing is a process whereby projections are tweaked for different "what-if" scenarios. For instance, if manufacturing costs were to increase from 28% to 30%, what is the impact on overall profitability? Or, if interest rates were to rise 2% over the next 12 months, what is the impact on cash flows as a result of increased loan repayments? This should be an important part of the business planning phase of any new business as a profit sensitive business can easily become unprofitable if certain variables change even slightly. It is also a valuable tool for existing businesses and can be used to determine break-even points particularly in businesses which sell goods.

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What Next?

Even if the importance of an effective financial management framework is recognised by a business venturer, a common assumption made is that financial management skills come naturally. It is important to recognise that the skills required to conduct quality business planning and create an effective financial framework are distinct from industry-specific skills and knowledge. If you are in business and feel there are inadequate financial management resources currently available within your business, contact your manager or partner at Enspira Financial to discuss your needs. We can assist you in establishing an effective financial management framework that will arm you with the information you require in order to make informed business decisions, and ultimately maximise the success of your business.

This above is by no means a complete representation of the financial management framework required in order to maximise business success. The framework required will be determined by the individual businesses and those managing it. It merely explains some of the standard tools and processes that can assist business owners in analysing business performance, making informed decisions, and better understanding their business generally.

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