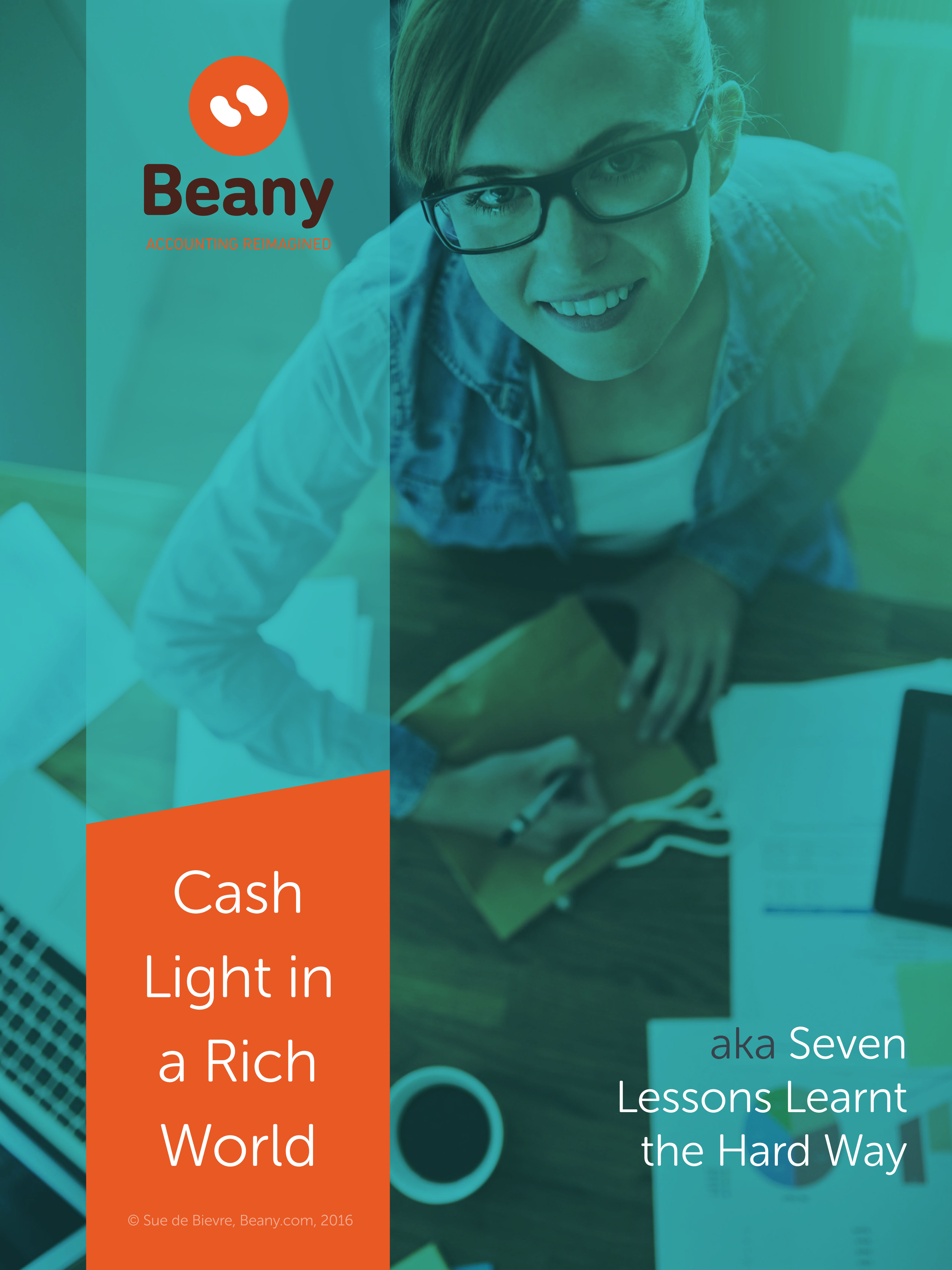

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Cash Light in a Rich World

aka Seven Lessons Learnt the Hard Way

What do cashflow issues feel like?

How does cashflow impact on business decision making?

What are the long term effects of the cashflow issues?

What are your primary business objectives?

Intellectually, we can understand what it means to be short of business capital. It can impede growth plans and frustrate good business practice as corners can be cut. But what does it feel like? What does it feel like at 3am on a Tuesday morning, when you can't sleep from the worry that you know wages need to be paid but there may not be enough money in the bank to cover it?

Almost every business owner will tell you - it's tough (if they're honest). That feeling of responsibility, and sometimes fear, can define being a business owner. Lack of money not only creates real business problems, it can also lead to long term business stagnation and even worse, affect people's health and well being. It can certainly damage relationships, both personal and professional. It is unhealthy at every level and yet is also remarkably common. Most small business owners 'bootstrap' their way from startup as they grow and establish their business... that is, doing it alone without much financial support or understanding from others.

So how can you avoid some of this pain, or at least know that you're doing the best you can?

LESSON ONE - Just because you can, doesn't mean you should

You can almost always raise money from somewhere, if you want it badly enough. But just because you can, doesn't mean you should.

Reality check: If you simply cannot access funds for your business, then that's a strong sign you're pursuing a bad idea.

If you can raise funds for your business, consider very carefully whether you should.

Here's some of the reasons why you should raise money:

- You have a profitable business, but you are new to business and you hit a seasonal downturn which you were unprepared for. Learn the seasonal cycle, and be prepared to borrow to get you through the seasonal trough. Put something aside in the profitable times next year.
- You have a profitable business, but you can be more profitable by investing in your business. You've done the maths and can see that if you invest some money now, you can grow your business or your profits.
- You are making a loss, but you are on a growth trajectory and understand how much more you need to invest to get to profit.
- Your business made a loss this year due to an unforeseen external event, such as the global financial crisis, or an earthquake. You have considered what may happen in the future and want to bridge the cash shortfall now as you have calculated how much you'll need to survive and have a survival plan going forward.

There are other good reasons to borrow money, but these are indicative.

Here are some reasons why you should **NOT** borrow money:

- Your business consistently makes a loss, but you hope that things will improve.
- You have a 'break-even' business and have been drawing money out to pay your own expenses, and now the business is beginning to feel cashflow pressure.
- You have a profitable business and now want to buy an expensive vehicle or a piece of equipment which will not add value to the business.

LESSON TWO - Alignment of purpose

If you really need some business cash, for whatever reason, you will find it much easier if you discover alignment of purpose with potential partners.

It is very common for entrepreneurs to expect people with money to just give it to them! Entrepreneurs sometimes struggle to understand why this rich person standing here wouldn't 'love to invest' in their amazing idea. The concept of 'angel investors' somewhat supports this point of view. It does not work like that, fortunately. Even the most angelic of investors is looking for a return, not for the chance to make an entrepreneur happy.

It is also relatively common for business people to be grateful to banks for lending them money - they are so relieved, they credit the banks with kindness.

Neither of these two positions are correct. The reality is that investors direct their funds where they believe in the likelihood of a good return, and it is the business of banks to advance money where they have security over the loan.

> Understanding the purpose of your potential partner makes the whole dynamic of borrowing money or raising capital much less stressful.

Banks want to make a margin on the money they loan with little or no risk. Typically they will only lend when they have something to secure against the funds (ideally land and buildings) but they will accept other forms of collateral in certain circumstances.

Second tier lenders are prepared to accept less solid security but require higher returns. They also generally favour specific areas of business lending to limit their risk (for example, UDC lend against plant and equipment).

Investors look for higher returns to offset the higher risk of investment. They are looking for good ideas, the track record of the team, scalability, other capital that has been attracted and the wider market.

Family, friends and fools will also provide capital and are often the first port of call for new businesses. They usually provide the most favourable of financial terms but the most onerous of emotional terms (refer to lesson 6)!

LESSON THREE

Why you want it will affect where you can get it

If you are looking for some further funds to support your business, the purpose of the cash will often determine where you can get it.

For example, the bank will lend you money against a vehicle or piece of machinery, an investor will lend you money to develop your marketing of a great product and your Mum might lend you the money to keep your business afloat!

> There are many factors that can determine where you may access the funds - timing, adverse events, growth, business failure, etc.

Often the 'why you need it' is easily identified, but it certainly pays to consider why you need the money and incorporate the reason into the approach to your potential partner or funder.

LESSON FOUR - What is the true cost of money?

Here are some simple ways to help understand the cost of finance:.

- The bank interest, rate secured against your house, is low because the bank can always sell your house.
- You can sell part (a 'share') of your company to raise money. When you're small, this can end up an expensive option. Famously, Facebook offered a painter either a few thousand dollars or some shares to paint their offices. He took the shares and eventually sold them for $200 million (the cost of that paint job was pretty steep, as it turns out!).
- The guy at the car yard is incentivised to offer you a great rate on a new car to make the sale. But he may not offer that rate first time around. He holds the interest rate as a bargaining chip in the negotiation on the price of the vehicle.

So what difference does a rate make?

Let's assume that you need $10,000 for your business. Here are some different financial scenarios for how much interest you will pay:

Business bank loan secured against your house at 4.39% over 3 years
=
$544

Credit Card debt repaid over 2 years at 20.95%
=
$1,766

Car dealer at 12% over 5 years
=
$2,445

Adding it to your mortgage
=
$4,274

Many small businesses will just top up the mortgage as it's an easy option, but if you have your mortgage over 25 years, this can be a very expensive option as shown above.

This is the financial cost, what about the other costs?

Debt really can have a tail of bad outcomes. There is an emotional and psychological load attached to debt which can take energy from positive activity. The interest is the tangible side of this but what about the weight of debt on you, your relationships and your business? Debt can slow the business down like an anchor, or it can create financial lift-off with additional cash creating opportunities that could not exist without it.

Debt can also have a moral component. Some religions even forbid the use of debt in business, recognising the dangers of unfettered access to money. This moral component was displayed in the recent GFC event which mobilised people (the 99%) into a more considered view of consumption, the money go-round and the role of banks in the modern society. At least temporarily, the shock waves created a more sober approach to debt.

Summary: Do the maths on your cost of finance and consider what other effects, good and bad, will flow from raising money

LESSON FIVE - Cash flow forecasts are the tool of the devil - and an essential part of the business plan

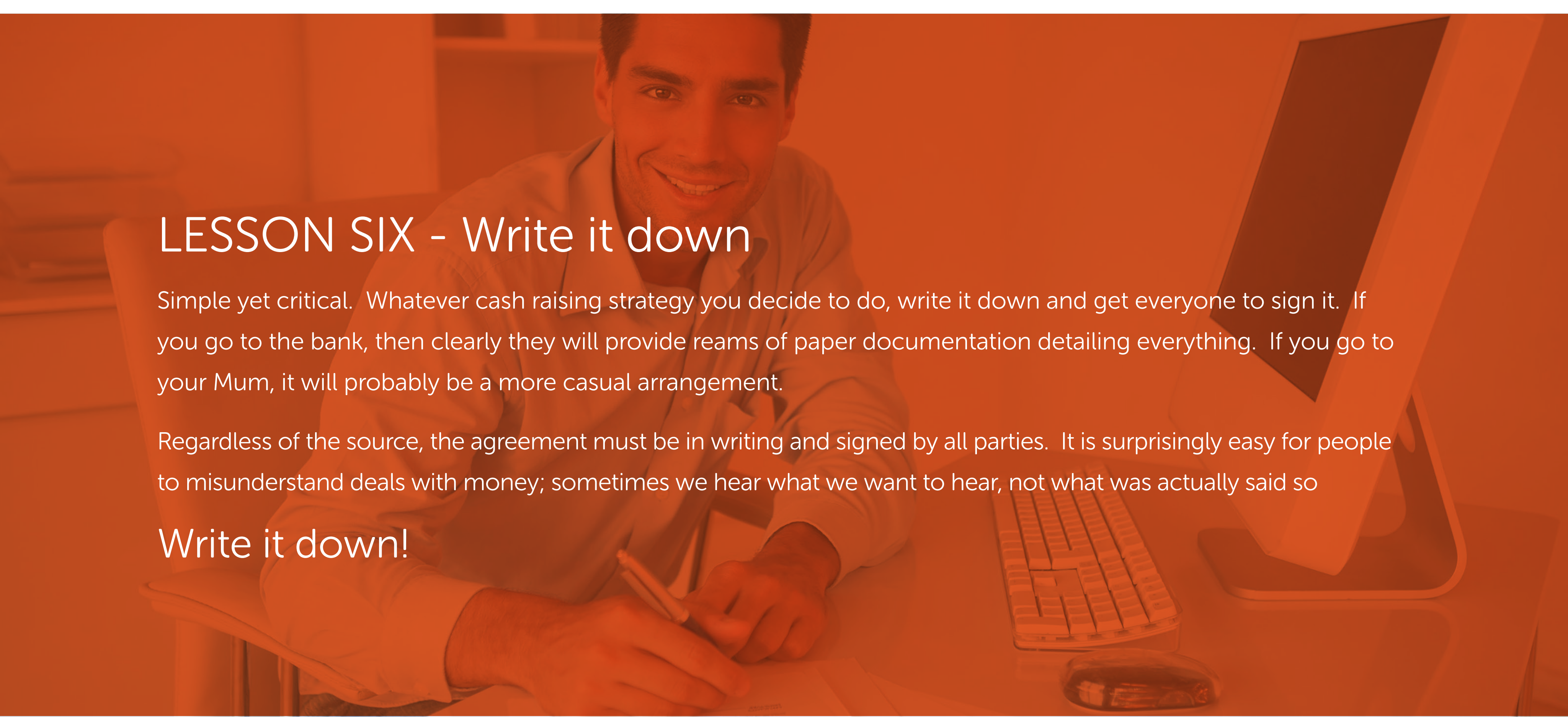
How do you know what you will need unless you make a financial plan, in the form of a cashflow forecast? And has any start up business ever followed a cashflow forecast?

Damned if you do and damned if you don't.

The bank or investors will insist on seeing your cashflow forecast when they are considering your request for funding, and then they beat you to death if you deviate from it, up or down (but especially down).

So should you do one? How should you prepare one and how should you use it? After years of pain in the trenches on this one, here is my distilled wisdom:

- Yes, definitely prepare a detailed cashflow with every key indicator identified.
- Forecast several scenarios - a base forecast for the bank and investors and a stretch plan for the team so you have something to aspire to.
- Input the forecast to your accounting system so you can see how you're going (ideally on a monthly basis). Investigate the variances and understand what's going on in your business. If it's not to plan, why not? What can you change?
- Be prepared to amend as you travel through the year
- Be prepared to defend/explain your forecast and deviations to the bank and/or investors regularly - better to be on the front foot than present a large nasty surprise at the year end.



LESSON SIX - Write it down

Simple yet critical. Whatever cash raising strategy you decide to do, write it down and get everyone to sign it. If you go to the bank, then clearly they will provide reams of paper documentation detailing everything. If you go to your Mum, it will probably be a more casual arrangement.

Regardless of the source, the agreement must be in writing and signed by all parties. It is surprisingly easy for people to misunderstand deals with money; sometimes we hear what we want to hear, not what was actually said so

Write it down!

LESSON SEVEN - Just because you can, doesn't mean you should

Why do you need the money? Finding money is never the answer. Understanding your reasons for needing it are.

If you have a deficit, you need to honestly seek the reasons which underlie the deficit. If you're not sure, or not completely sure, use an expert or a qualified friend to help you achieve absolute clarity on this point.

It is too easy to raise money to fill an operational gap which is created by poor profitability (or lack of profitability) instead of correcting the business model to plug the hole.

> Our Top Tips For Business Profit Improvement

Step Through Diagnosis of Cash Light in a Rich World

Recognise the problem - are you cash light?

Diagnose the issue - why are you cash light?

Face the reality - acknowledge the truth

Make the case - explain why would someone lend to you

Find your allies/friends/advisors - who are you potential partners?

Plan your future - build your cash flow forecast and assumptions

Change your future - make your changes

Change to **Beany**

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