

Common Finance Mistakes

1. What management accounts?

Many small businesses don't produce regular (i.e. monthly) management accounts. It's easy to see why not. Bookkeeping is seen as confusing and time consuming, bookkeepers are expensive and understanding and interpreting a set of accounts is a skill that only comes with practice.

Running a business without regular management information is a common cause of business failure. Problems are often identified only when it's too late to do anything about them.

Not only that, but it's virtually impossible to grow a business effectively without installing a decent management information system. Many owner/managers rely on a gut feel of how the business is doing, rather than a formal monitoring system. This can work for a very small business (although we wouldn't recommend it), but as the business grows and employees are added, it becomes impossible to keep all the figures in your head.

If you don't have a system for producing monthly management accounts, then get one now. This means hiring an accountant or bookkeeper to maintain your accounts or learning how to use an off the shelf accounting package such as Sage or Quickbooks (there are many others). At a minimum, you should produce the following *monthly*:

Profit and loss account. You really only need three numbers here: sales, direct costs and total overheads. From this you can get the gross profit (sales less direct costs) and the net profit (sales less direct costs less overheads). These figures should rule your life.

Balance Sheet. If you don't understand the Balance Sheet, you should just focus upon the Accounts Payable/Creditors/people you owe and the Accounts Receivable/Debtors/people who owe you.

2. Having a permanent overdraft

An overdraft has its good points and bad points. On the bright side it is a very flexible way of borrowing money in that (a) you only pay interest on the exact amount you need to borrow at any one time and (b) you don't have to pay it off in fixed amounts.

On the minus side, it's expensive. The rate of interest can be between 30% and 100% higher than on a standard bank loan.

The banks bang on about overdrafts only being temporary measures and, for once, they're right. If your bank overdraft never goes below £10,000 or £20,000, then you should consider converting it into a term loan. This will (a) be cheaper; (b) force you into the discipline of repaying the loan and (c) be more secure, as the bank cannot ask for immediate repayment of the loan as they can with an overdraft.

While we're on the subject of overdrafts, many businesses run one even though they have a lump of cash sitting in a savings account somewhere else. Perhaps this is to do with some sort of survival instinct – the fact they have some savings, even though they also have an overdraft. Whatever the reason, it's very poor financial management. The differential between the overdraft rate and the savings rate is probably in excess of 10% (e.g. 14% overdraft rate and

4% savings rate), which means a £10,000 overdraft matched by £10,000 of savings is costing over £1,000 per annum. Pay off the overdraft and spend the £1,000 on the staff Christmas party.

3. Not investing in the things that matter

Investing means spending today, to reap the benefits at some point in the future. It isn't restricted to spending money. It also covers spending time, often a scarcer resource.

Small businesses often find strategic investment difficult. Many owners/managers are caught up in the day to day detail of running the business and find it difficult to step back and look at the bigger picture - what is the medium term target for the business and what type of investment does it require to get there?

In our consulting experience, the two main areas in which small businesses fail to invest sufficiently are:

People - Investment is in the form of staff training and development as well as general systems and procedures (induction, regular appraisals, staff communication etc). (See the Human Resources Mistakes).

Product Promotion - If you want to grow your business you must spend a proportion of revenue on promotion. This isn't just advertising (often this is the least effective form of investment) but includes all forms of promotion such as public relations, customer entertaining, direct mail, special offers, free gifts, stationery, website design etc..(see the Marketing Mistakes)

Of course, as well as the two issues above, you should be investing in other aspects of the business such as information technology, financial controls, new product development etc..

Don't be afraid of investment - the most successful small businesses are the ones who understand that in order to grow, you need to spend.

4. Frightened to ask your customers for money

Some people don't like asking for money either in their private lives or in business. It's embarrassing. This is especially the case in companies where the person doing the selling is the same person chasing the debt.

In order to avoid embarrassment, you need to do two things in advance.

1. Ensure that your terms of business are clear and communicated to all clients. Don't just do this once at the beginning of the relationship. Ensure that all invoices and statements include the main terms of business.
2. Vet clients thoroughly. Ask the client for references from other suppliers and consider obtaining a credit reference from a credit agency. This isn't expensive and may save you money in the long run by revealing chronically bad payers before you commit to them. If the client is a company, obtain a copy of their most recent accounts from Companies House.

When it comes to recovering the debt, if you do have a strong sales relationship with the customer, and you're worried about jeopardising it, you could consider getting someone else in

the company to chase after the money. This is a double-edged sword, however. Your customer may be upset and annoyed that you haven't dealt with it yourself.

A couple of other debt collecting mistakes to avoid:

1. Some people think of offering "5% if settled by the 2nd of the month". Be careful about doing this as some clients (especially larger companies) will pay you a month later and still take the 5% discount. Can you then be bothered to chase the 5%?
2. Don't write "Initial" or "First" demand in your letters requesting payment. It presumes there will be others to follow so why should the customer pay now.

5. Government grants for everyone

You may be tempted to pay a grant finding company a few hundred pounds in the hope that they will help you get a government grant. Our advice is - be wary of such companies. Typically:

1. The company promises to find you lots of grants for which you are *eligible* (being eligible is one thing, getting them is another).
2. They ask you a few questions about your business.
3. From those questions they look at their database of grants and identify the ones for which you may qualify.
4. They ask for the applications forms from each grant provider on your behalf. They do not do the useful bit and apply for you.
5. Each application form requires mountains of information and would take the most sane and patient individual a week to fill out. And having filled it out, the chances of getting the grant may still be fairly slim.

There are thousands of different grants available for small business and they can come from a number of different sources (European Social Funds, local government, DTI, private industry, Prince of Wales Trust).

Even if you are a good quality candidate for a certain grant you may not get it because the funding for that year has run out. Most grants either (a) fund a limited number of companies annually or (b) only have a certain amount of cash to provide. In either case, once they're used up, that's it. You'll just have to wait for next year's allocation.

Very rarely (almost never) are there grants which provide straight cash. Usually they subsidise the costs of such things as (a) training, (particularly for the unemployed); (b) exporting (they may help pay for foreign research trips or trade shows); (c) rejuvenating declining areas (help with training); (d) innovation (advice on patenting and funding) and (e) business growth consultancy.

Rather than pay a grant finding company, visit your local Business Link who can advise you on eligibility for nothing.

6. Banks are charities (not)

Some small business owners believe that banks should take on a sort of charitable role to help the business community and society in general. Such an attitude often leads to a poor relationship with banks characterised by one or more of the following:

- A feeling that banks are 'arrogant', because they turned down a particular loan application
- A reluctance to provide the bank with 'sensitive' information - 'Why don't they just give me the loan without all this messing about...'
- A habit of changing banks frequently resulting in a number of rarely-used bank accounts with different banks

In case there's any doubt, let's be clear, banks have one sole objective – to keep their shareholders happy and make them richer. And before you get all hot under the collar about that, it's worth noting that these 'shareholders' are mainly UK pension funds who are acting on behalf of - yes, you've guessed it - you (assuming you have a pension that is).

It's highly likely that, at some stage in your business life, you'll need finance from the bank of some sort. The best thing you can do is to anticipate this requirement and build a good relationship with the bank in advance. That way, when you need the money, you can be pretty confident of getting it.

Building a good banking relationship is easy.

- Start by treating the bank with the courtesy you would give a new and important client.
- Be pro-active in your communication, for example by sending your annual accounts to your manager with a short covering letter summarising your (excellent) year.
- Anticipate your funding requirements well in advance. You're much less likely to raise finance if you leave it to the last minute and seem desperate.
- Finally, treat your account manager's comments with a degree of respect and, if it's at all possible, consider implementing one or two of his or her suggestions.

If you don't think that a small business account manager with fifteen years of experience has anything of relevance to say about your business, then dare we say that you're not in a position to accuse anybody of arrogance.

7. Bookkeeping (again)

Many small businesses struggle endlessly to find a bookkeeper that they trust and get on with. Small business owners are, by nature, risk takers, whereas bookkeepers are, by nature, cautious and risk averse. There's a difference in culture here, which often results in a poor quality relationship.

Some companies hardly have any contact with their bookkeepers other than sending plastic bag loads of receipts occasionally and receiving VAT returns, payroll slips and annual accounts in return.

This might be fine if you have good procedures in place, but if you haven't and the bookkeeper is left to his or her own devices you may find that (a) the accounts don't reflect the true state of the business and (b) you're paying more tax than you should because items are being overlooked.

Ignore the differences in outlook and work with, not against, your bookkeeper. This can be as simple as sorting out invoices and receipts into categories and sending them in separate pocket files (rather than chucking everything in a Tesco bag).

If your financial skills aren't up to much, you should consider getting someone, perhaps your accountant, to check over the books from time to time during the year. Otherwise if your bookkeeper is doing a poor job, you wouldn't find out until the end of the year.

Due to their frustration with their bookkeeper, many small businesses ask their accountant to do the bookkeeping at the year end. Accountants are rather for this job, however and it can be very expensive. Don't do this unless the accountant has a dedicated bookkeeping function which charges itself out at bookkeeping rates.

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