

Simple Facts of Accounting

from **infoCPA**



No: **5**

Surviving the Pitfalls of Small Business

Introduction

This bulletin addresses the most common reasons for, and makes suggestions for avoidance of business failure. As many businesses fail for management reasons, it is important to realise that people starting and running businesses must quickly learn the essential skills, which are basic to any business operation.

These skills are

1. An understanding of and ability to manage business finances.
2. An understanding of markets.
3. Buying and Selling skills.
4. Costing and Pricing capabilities.
5. Budgeting and Planning processes.

Taking positive action to improve knowledge in these areas can be considered the first step towards professionalism. The second step is to actually put into practice what has been learnt. Carelessness or indifference to this process of learning, - and it is a continuous process - will sooner or later lead to one or more of the specific causes of failure.



Ten Most Common Causes of Business Failure

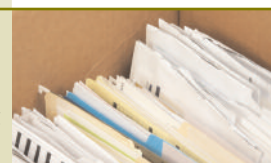
(1) Cash Flow Problems

Cash is the life-blood of any business. No cash - no business. Many concentrate on making profits, but profits are not much use if they are tied up in the business. A cash flow problem is very easy to recognise. Avoid business failure by improving Cash Planning and Control.



(2) Lack of Capital

Most new companies are under capitalised which is difficult to correct. Be clear about how much money will be needed to fund the operation of a business for the first year at least. Another key tip is to discount even further your expectations of cash inflows therefore helping you to identify a realistic amount of capital that is required for success.



(3) Lack of Current Regular Financial Information

Reliance on Annual Audited Accounts is inadequate because of their historical nature. The use of current financial information to predict difficulties in the coming months and taking corrective action is vital. Perfect the knack of having key "red hot" financial indicators (monthly turnover, gross profit & net profit margins, debtor/creditor/stock days, bank balances and taxes outstanding).



(4) The BIG Contract – "the ultimate dream!"

Resist taking on a contract or "Line of Work" of such size that if anything goes wrong during the contract, the entire business is mortally wounded – this involves great strength of character! You may also risk losing contact with other customers if the contract is of very long duration. It is wise to know exactly how the business was won. Know exactly what is involved if you choose to undertake "The Big Contract." Ask: Do we currently have sufficient resources to fulfil this order? Is there the plant/machinery or stocks to complete the work? Is there retention money, and is this the profit margin?




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(5) Small Customer Base

Beware of over reliance on one or two large customers. If they go - you go. Broaden your base of activities to avoid relying on one or two large customers or suppliers. The success of the business should not be dependent on one or two people outside the control of the business, or even a Government Department.



(6) Overtrading

This occurs when a business expands faster than its capital base and eventually the business cannot meet its commitments. Ensure cash reserves or profits increase at the same rate as or higher than turnover, working capital requirements, bank loan and interest payment increases.




(7) Costing and Pricing

These are separate subjects that are inevitably linked by the end profit result. It is essential to know the real cost of producing your product or service. Know what price to set, when to change this price and avoid under-costing – this requires a combination of judgement, intuition and skill. If prices are too low expenses will not be covered, if prices are too high sales will be lost.




(8) Inability to Generate Sales

The inability to generate sales is a major cause of business failure. Little or no market research is a contributing factor to sales not being achieved to plan. It is essential to research and know your market. Ask yourself: Do you really understand the market you are in? Do you know your target customer groups? Do not underestimate the power of marketing and research – both will help with your sales plan.




(9) Practical Planning For Growth

Management should have sufficient understanding of the financial implications involved in strategic and marketing decisions. Decisions made in isolation can result in disappointing bottom line results at best, or cash flow shortages, overtrading and eventual collapse, at worst. Be aware of the implications of growth including an increase in the need for working capital, labour, fixed assets and capital funding. It is essential to identify who will fund these increased needs! Growth will also result in a decrease in time available making everyone busier!



(10) Excessive Personal Drawings

A proprietor and his/her family living beyond their means is a threat to a business – this is a problem that most family businesses suffer from. Personal drawings should not exceed profits under any circumstances. The prudent businessperson should ensure sufficient profits are retained in the business for future developments.



Conclusion

There is no guarantee of success in business. The risk of failure can be reduced – but not eliminated – by planning along the lines outlined above. But remember, failing to plan is effectively planning to fail!



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For further assistance...

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