

Understanding SMEs and Their Business Environment

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JULY 2012

PART 3

Helpful



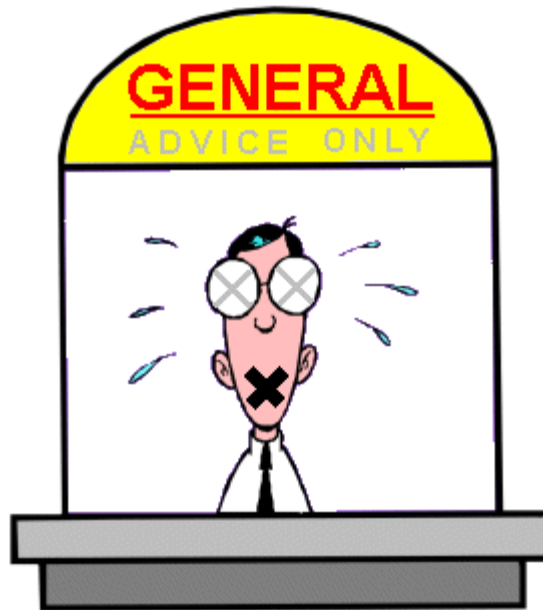
Reminder

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- The following are pieces of advice over and above what was already covered in Parts 1 and 2 --- although some of them were briefly mentioned
- This advice is NOT in any priority or order of importance. The advice is separated in 3 segments:
 - A) General (Strategic)
 - B) Financials
 - C) Operational

General Advice

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Advice #1

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- **Do something you enjoy or love**



Advice #2

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- Have a **Business Model** and follow it. Ensure that your business model fits with your vision and strategy for success
- The next page outlines the aspects and topics that need to be addressed by the Business Model. Although the model looks big and complex, it is actually very simple. All it takes is to have the patience to sit down and write out the ideas that are already in your head

What business are we in? Our business model

Value Architecture

Offer

- What is our offering?



Distribution architecture

- How do we reach our customers?
- How do we communicate with our customers?



Value chain

- What are our value creating steps?
- What is our value chain?



Core capabilities

- What are the core capabilities we need?



Partner

- Which partners do we need?



Value Proposition / Customer

Customers

- Who are our customers?
- What job do we solve for our customers?



Customer Benefit

- What benefit we create for our customers?
- What benefit do we create for our partners?



Revenue Model

Cost structure

- Cost structure is defined by the value architecture



Sources of revenue

- With what do we earn money?



Culture / Values

Leadership style

- What leadership style do we have?



Relationship style

- How do we interact with each other and the customer?

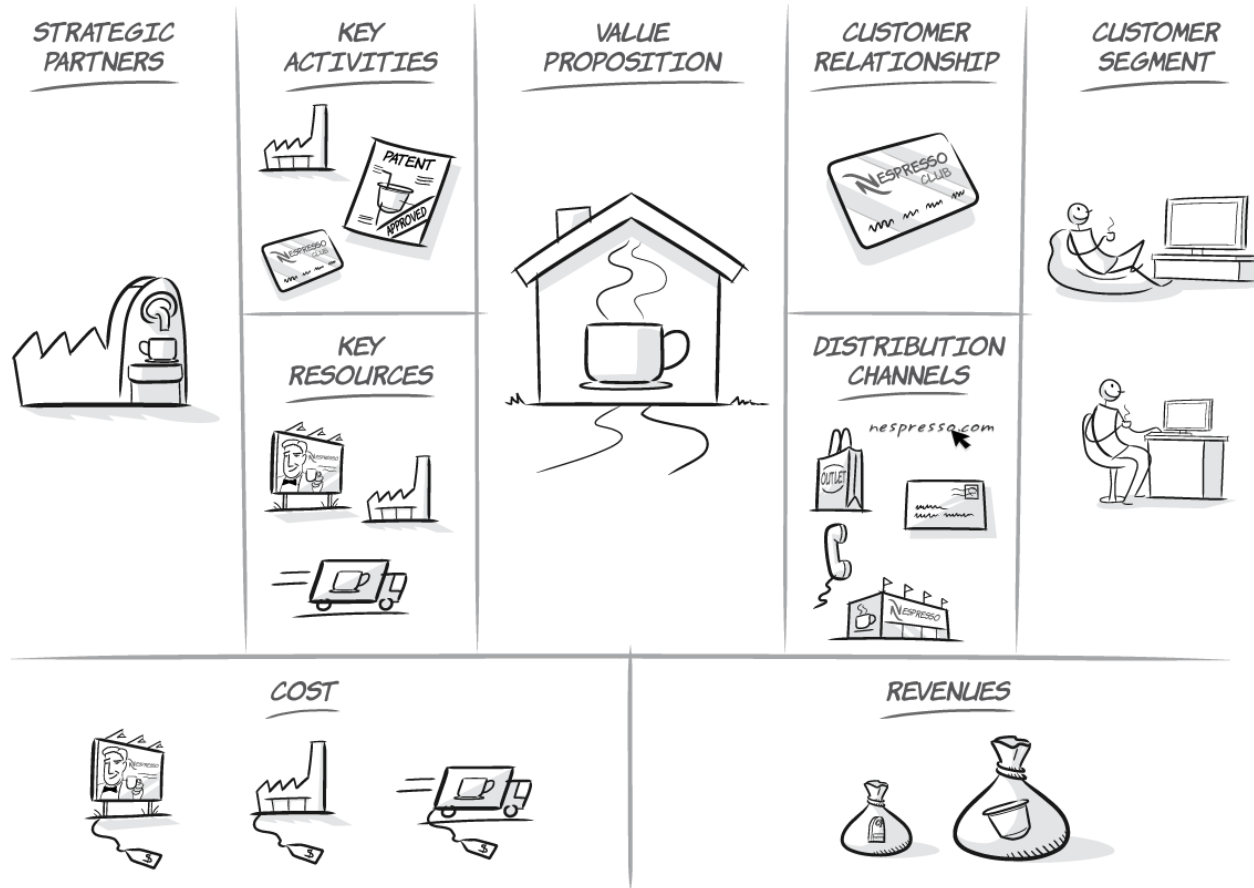


Values

- What values do we pursue?

An Example From A Coffee Shop Franchise

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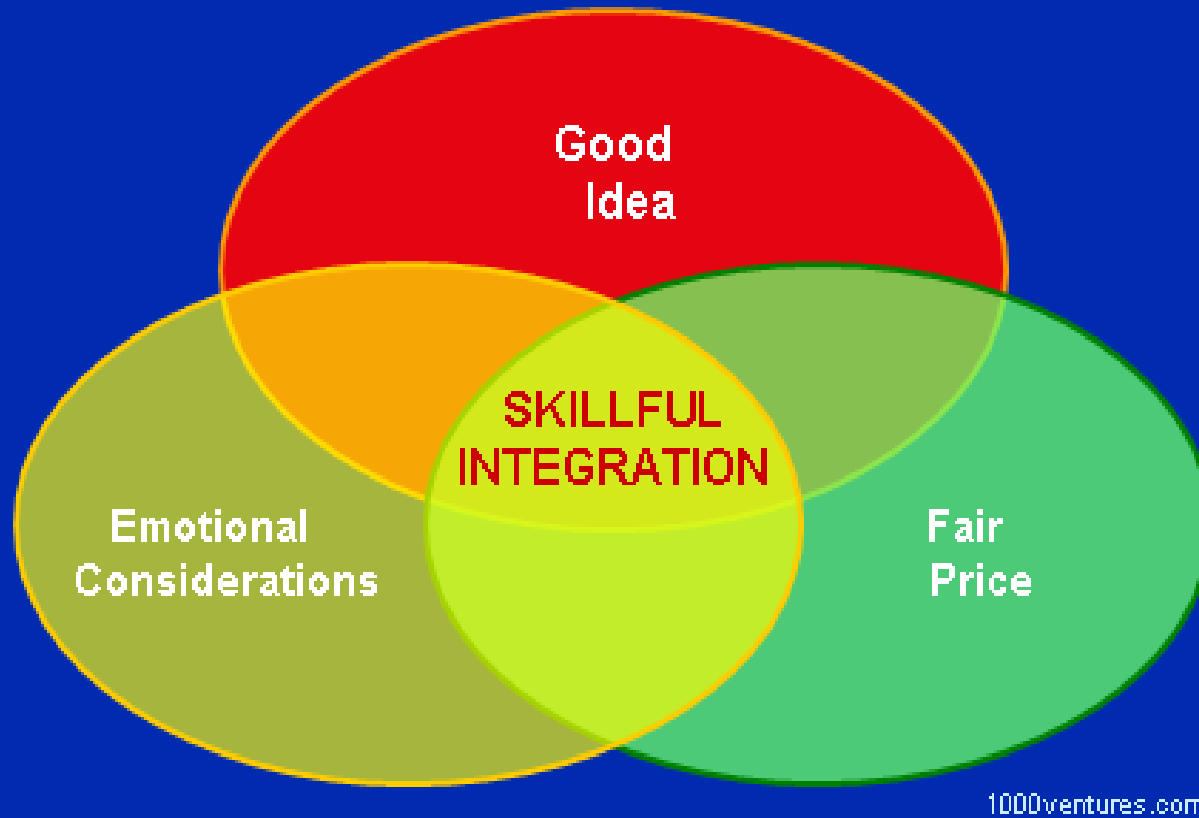
What Is A Value Proposition

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Customer Value Proposition

The Best Technique to Win the Customer Over



Advice #3

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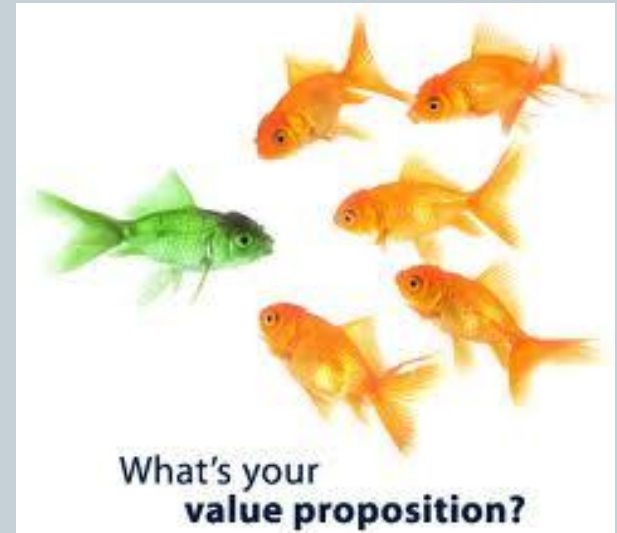
- Enhance your **value proposition**

- Differentiation

- ✦ Unique value
- ✦ Quality
- ✦ Price, Cost
- ✦ Performance
- ✦ Speed
- ✦ Reliability
- ✦ Convenience
- ✦ Array of Services, etc.

- WOW Factor

- Brand Name



So ...

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- Who are your key or strategic partners?
- What are your key activities?
- What are your products and services?
- What are your key resources or core capabilities?
- What is your value proposition?
- Who are your customers or customer segments?
- What are your marketing channels?
- What are your sales channels? Or revenue streams?
- What is your cost structure?

If You Don't Know The Answers ...

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The Business Model Canvas Designed for: _____ Designed by: _____

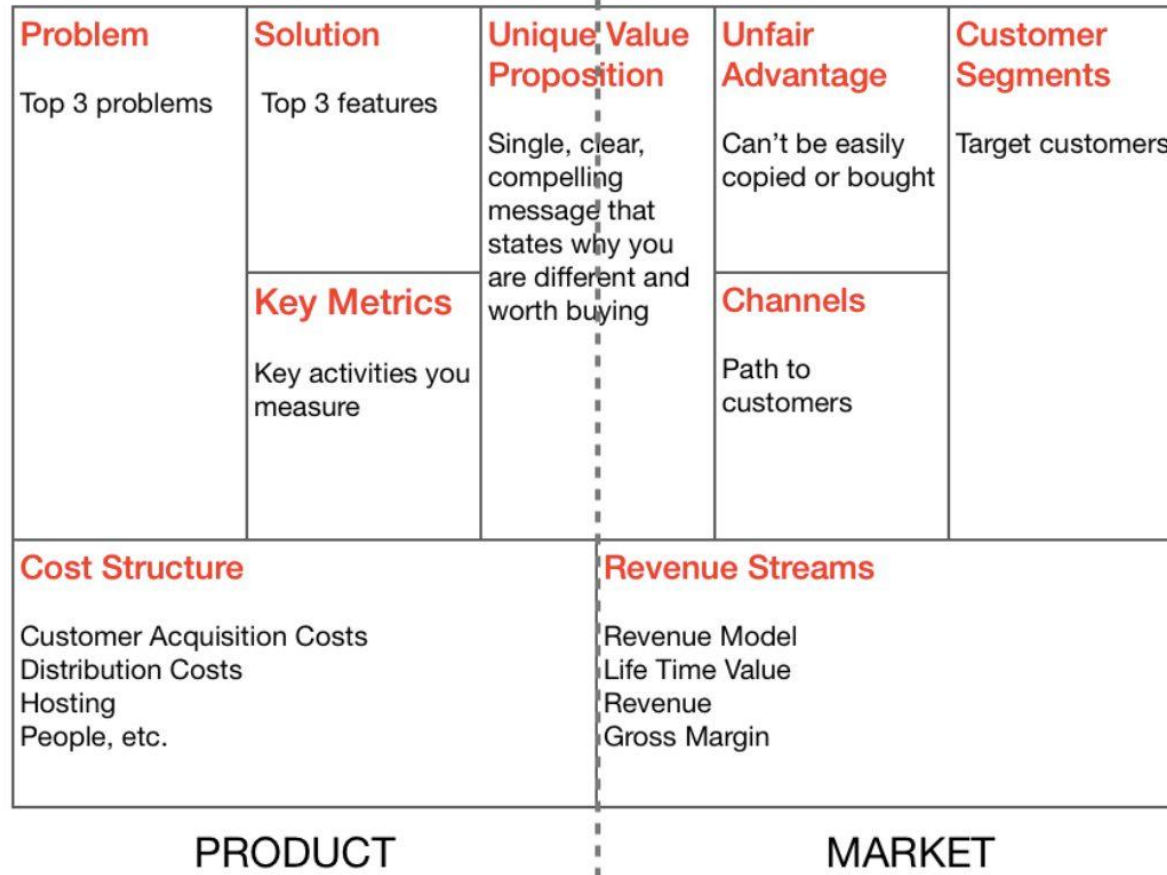
On: _____ Iterations: _____

Key Partners  Who are our Key Partners? Who can we buy from? Which Key Resources do we acquire from partners? Which Key Activities do partners perform? Guess	Key Activities  What Key Activities do our Value Propositions require? Our Distribution Channels? Customer Relationships? Revenue Streams? Guess	Value Propositions  What value do we deliver to the customer? What problem do our customers have that we help to solve? What bundles of products and services are we offering to each Customer Segment? Which customer needs are we satisfying? Guess	Customer Relationships  What type of relationship does each of our Customer Segments expect us to establish and maintain with them? Which ones have we established? How are they aligned with the rest of our business model? Guess	Customer Segments  For whom are we creating value? Who are our most important customers? Guess	
Key Resources  What Key Resources do our Value Propositions require? Our Distribution Channels? Customer Relationships? Revenue Streams? Guess	Channels  Through which Channels do our Customer Segments want to be reached? How are we reaching them now? What are our Channels' segments? Guess	Cost Structure  What are the most important costs inherent in our business model? Which Key Resources are most expensive? Which Key Activities are most expensive? Guess			Revenue Streams  For what value are our customers really willing to pay? For what do they currently pay? How are they currently paying? How much does each unit cost to sell? How much does each Revenue Stream contribute to overall revenue? Guess

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Use The Business Model To Identify Your Weaknesses and Problem Areas

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Lean Canvas is adapted from The Business Model Canvas (<http://www.businessmodelgeneration.com>) and is licensed under the Creative Commons Attribution-Share Alike 3.0 Unported License.

Advice #4

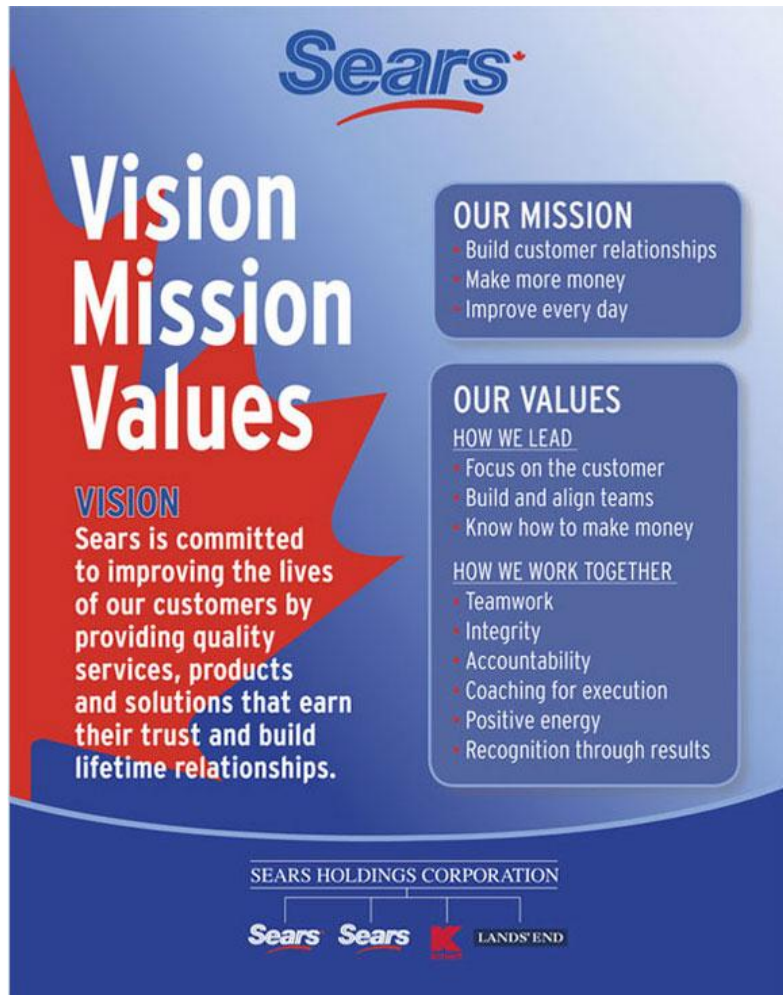
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- Establish your **mission and vision**



Great Examples

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Sears

Vision Mission Values

VISION
Sears is committed to improving the lives of our customers by providing quality services, products and solutions that earn their trust and build lifetime relationships.

OUR MISSION

- Build customer relationships
- Make more money
- Improve every day

OUR VALUES

HOW WE LEAD

- Focus on the customer
- Build and align teams
- Know how to make money

HOW WE WORK TOGETHER

- Teamwork
- Integrity
- Accountability
- Coaching for execution
- Positive energy
- Recognition through results

SEARS HOLDINGS CORPORATION

Sears **Sears** **K** **LANDS'END**



Outdoor Cap

Advice #5

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- **Develop your strategies.** Strategies can be nothing more than a handful of strategic goals that will help you improve your business and stay true to your mission and vision



Typical Critical Success Factors

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- Deep/profound knowledge
- Good Management
- Positive employees
- Positive relationships
- Constant growth
- Great community(ies) (online and otherwise)
- Cost control
- Good reputation and image
- Continuous improvement (strive for excellence)

Example Of A Retailing Strategy

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- Tap the local market to the fullest
- Build long-term relationships with customers
- Listen to the VOC (Voice Of the Customer) and expand your product and service portfolio accordingly
- Exploit portfolio of famous brands
- Deliver legendary service
- Become an active member of the community --- become a known quantity
- Add e-Retailing (a.k.a. e-Tailing)

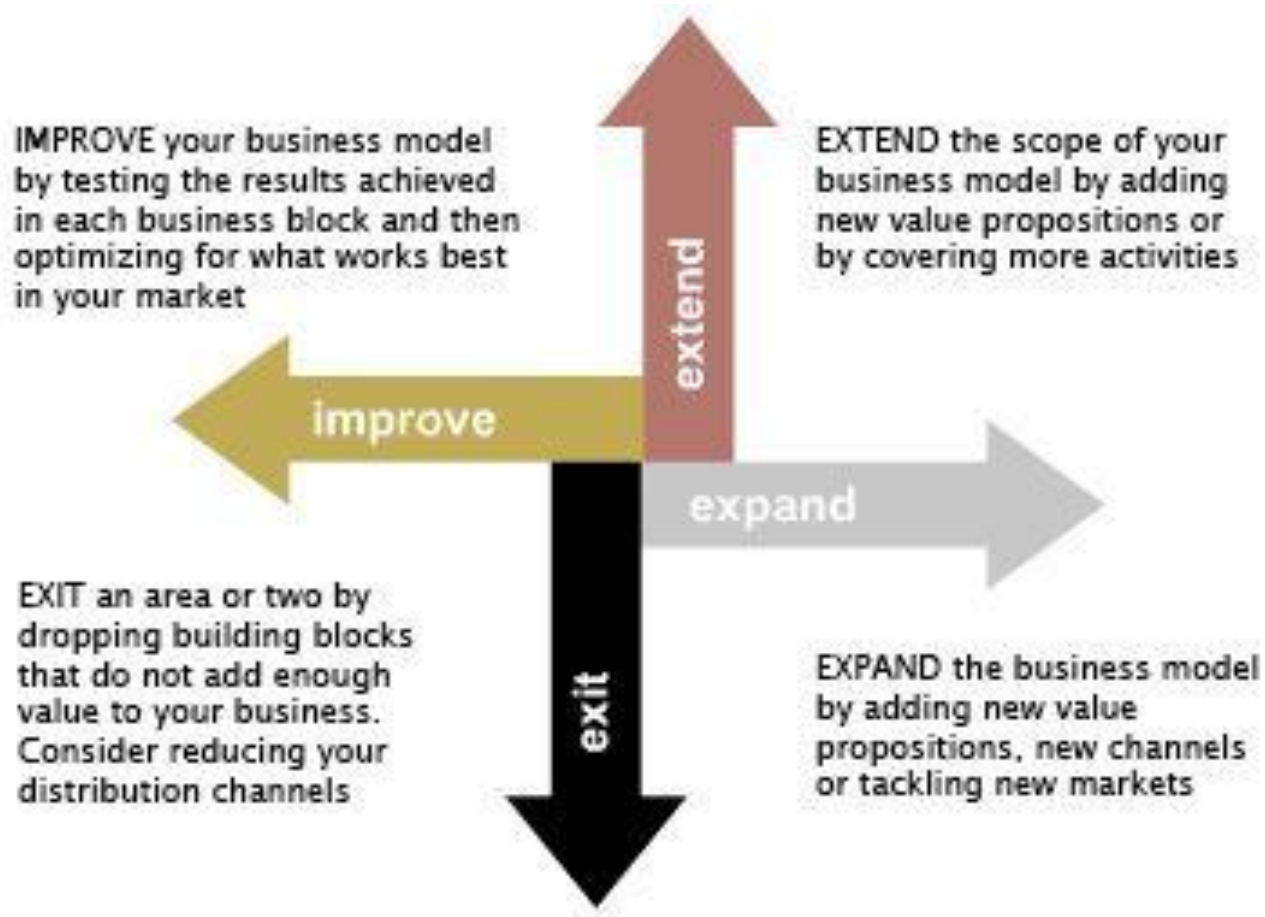
Example Of A Retailing Strategy

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- Improve Inventory Management
- Add Bar Coding
- Add a POS system and tie it to Inventory Management and Accounting Systems
- Improve Pricing Strategy and Profitability
- Improve Customer Service
- Find better and cheaper suppliers
- Reduce purchase costs

Consider These To Improve The Biz Model

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Advice #6

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Advice #7

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- Convert your goals into **measurable objectives** (by adding metrics and/or targets). For example:
 - Add 10 new products and 3 new services
 - Improve Customer Satisfaction by 5% or reduce customer complaints by 7%
 - Reduce inventory by 10%
 - Reduce theft/shoplifting losses by 8%
 - Increase revenues by 12%

Reminder

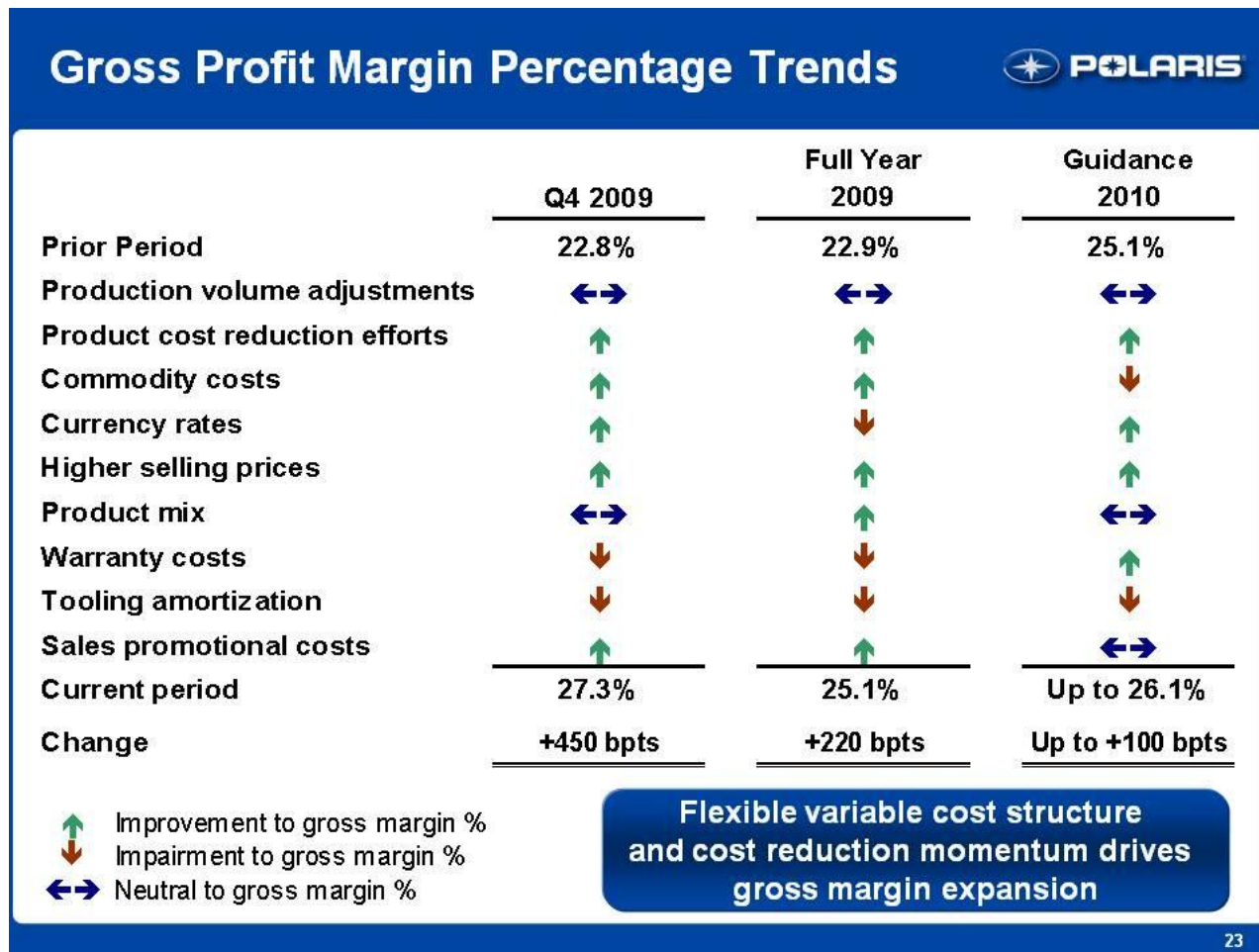
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- That which is not measured gets ignored and cannot be improved or managed properly



Example

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Advice #8

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- **Allocate the right resources**, budgets, time and energy to execute your goals & objectives.



Advice #9

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- **Track your progress** monthly and year after year. Review the trends and see if there are any warning signals or red flags that come up



Advice #10

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- Make **strategic moves**. Catch competition by surprise. Keep them guessing and keep them off-balance and off-guard. Don't be afraid to take risks. There is no such thing as risk-free business



Advice #11

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- *“You know what real power is? **Real power** is when you are doing exactly what you are supposed to be doing, the best it can be done. And nobody has to tell you, “You go, girl,” because you know, you’re already gone.”*

Oprah Winfrey

Advice #12

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- “**Delegate** with confidence. Surround yourself with people who are wise and competent. Empower them to perform and do not become intimidated by their expertise.”

Bishop T.D. Jakes

Advice #13

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- *“Those three things **autonomy, complexity, and a connection between effort and reward** – are, most people will agree, the three qualities that work has to have if it is to be satisfying.”*

Malcolm Gladwell

Advice #14

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- *“Look around. You’ll see the marketplace (every marketplace) rewards **innovation**: things that are fresh, stylish, remarkable, and new.”*

Seth Godin

Advice #15

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- *“There’s a redemptive power that making a choice has, rather than feeling like you are an effect to all the things that are happening around you. Make a choice. Just decide who you’re going to be, how you are going to do it. Just **decide and from that point the universe will get out of your way.**”*

Will Smith

Don't Discount The Involvement Of God And Destiny

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Advice #16

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- *“Experience taught me a few good things. One is to **listen to your gut**, no matter how good something sounds on paper. The second is that you’re generally better off **sticking with what you know**. And the third is that **sometimes your best investments are the ones you don’t make.**”*

Donald Trump

Advice #17

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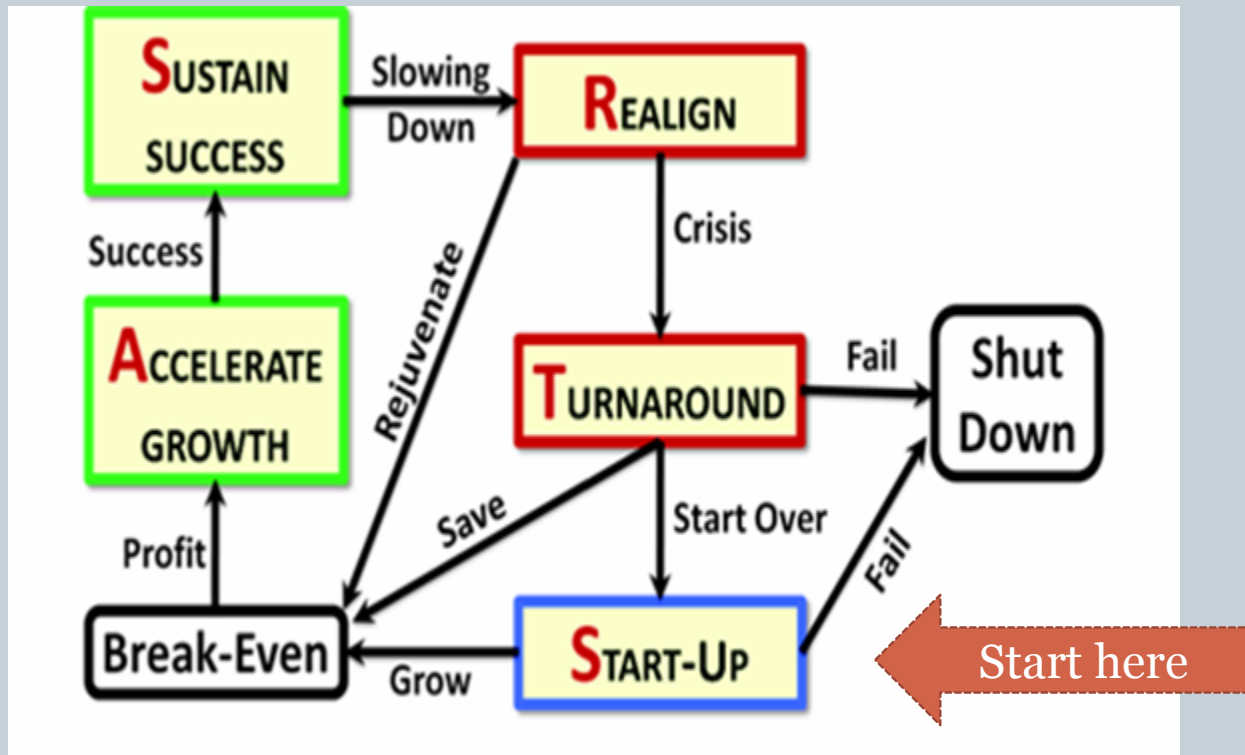
- *“We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next ten. Don’t let yourself be lulled into **inaction**.”*

Bill Gates

Advice #18

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- **Sustain success.** Know when to realign/reinvent



Source: The STARS Model of Business Evolution (Watkins 2003, 2009)

Advice #19

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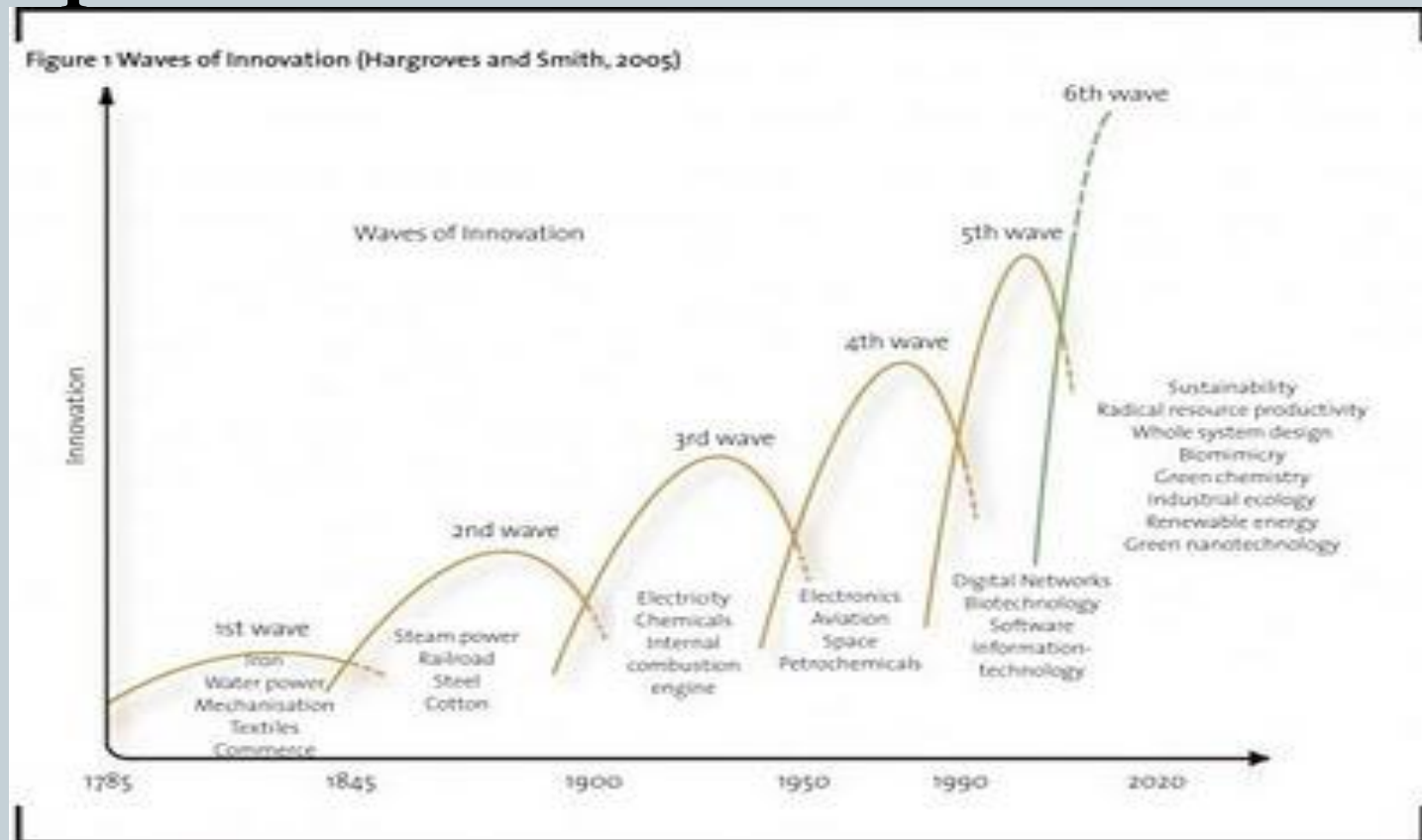
- **Advance to Significance.** It is even more fun there!!!



Advice #20

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- Take advantage of the megatrends; **be an early adapter**



A Little Humor

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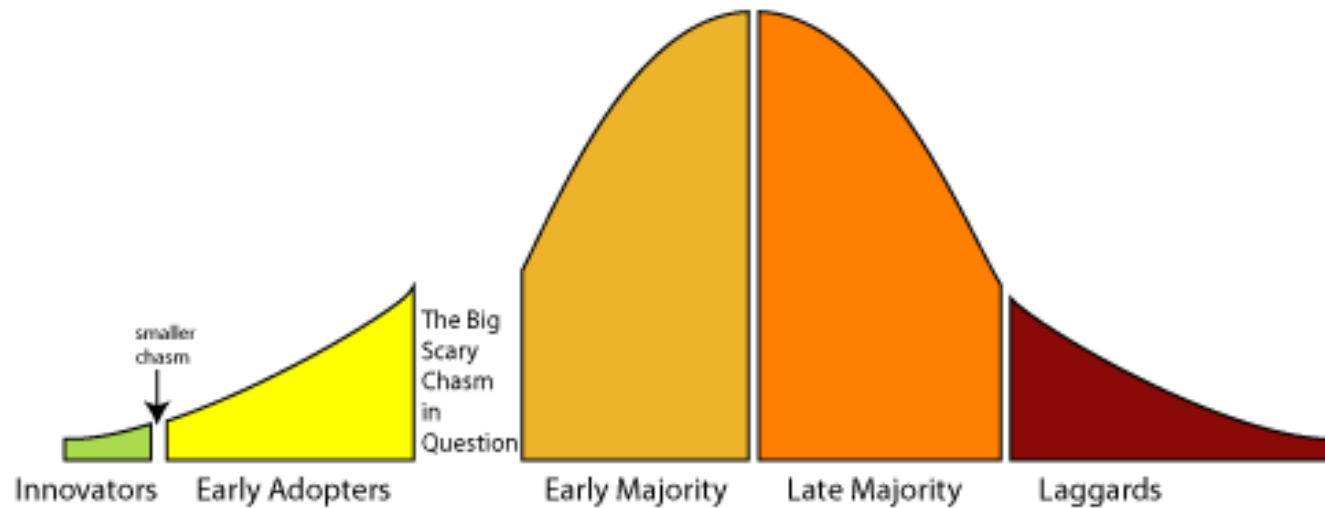
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**"Janet always was ahead of the curve...
she outsourced herself."**

Don't Be A Laggard ... They Die

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Geoffrey Moore's 'Crossing the Chasm' diagram
circa 1991



Advice #21

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- Do as much marketing as possible. **Guerrilla Marketing** is perfect for SMEs

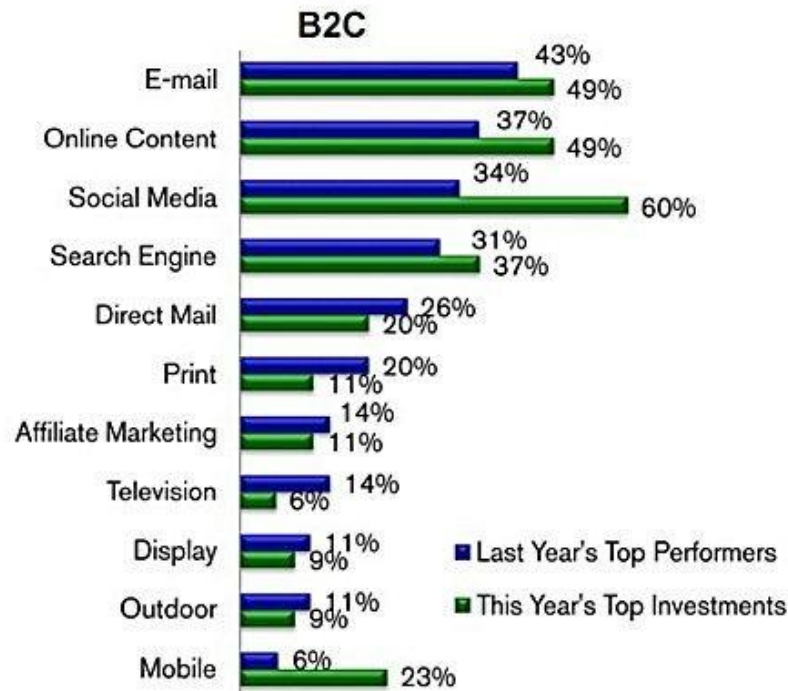


Reminder

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- Leverage the right **marketing channels** for you company

Marketing Channels:
Last Year's Top Performers vs. This Year's Top Investments

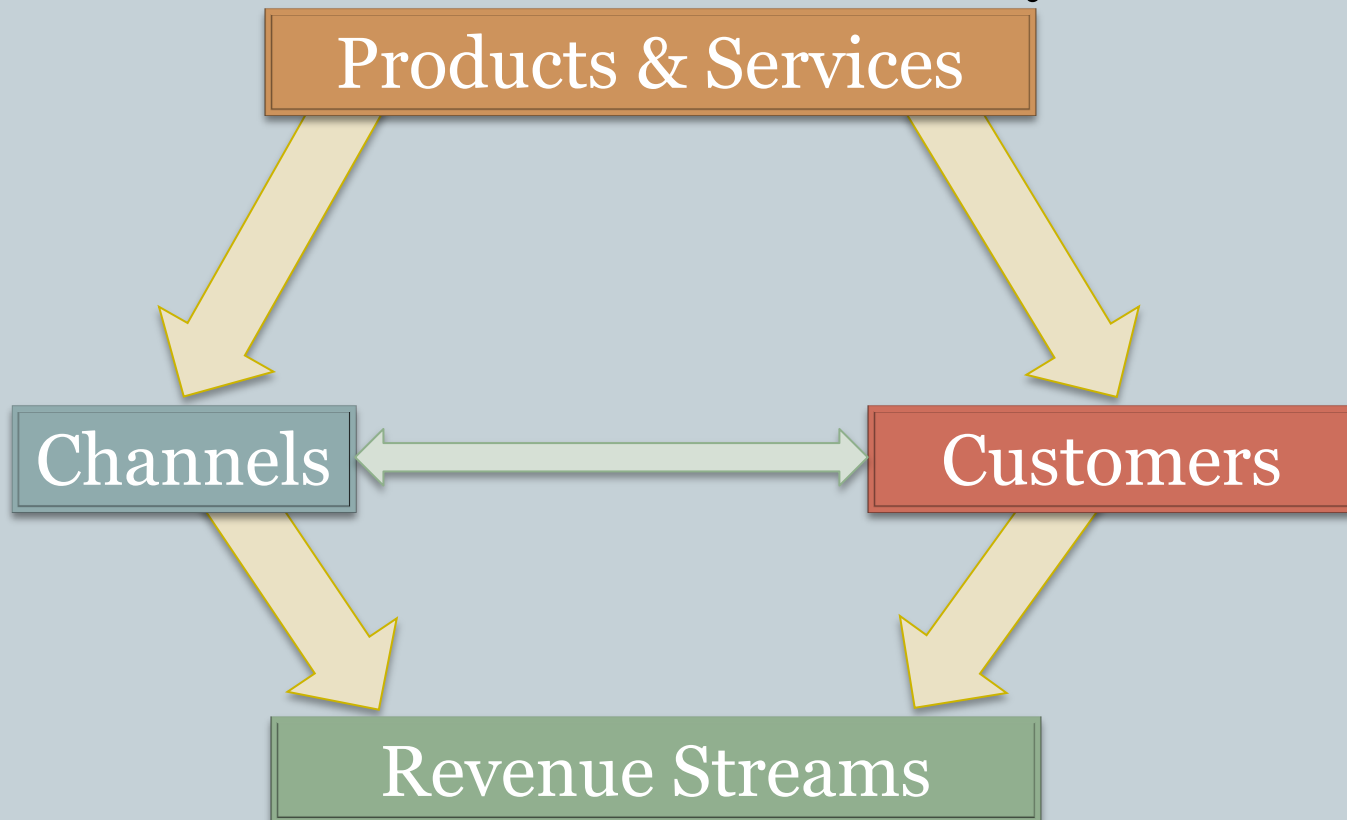


Focus.com, Marketers' Benchmark Survey, June 2011

Advice #22

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- The **more products and services** you add, the more channels and more customers you will have



Financial Advice

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Advice #23

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- Learn **Financials** and use the info to manage your business wisely
 - Ask questions such as:
 - ✦ What are my financial targets?
 - ✦ How much should I spend?
 - ✦ Where should I invest my money now?
 - ✦ What will give me the best pay off long term?
 - ✦ What investment will strengthen my position?
 - ✦ What do I need to cut?

Advice #24

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- Structure the business the right way, starting with the way you **incorporate**. Protect your business, your assets and yourself

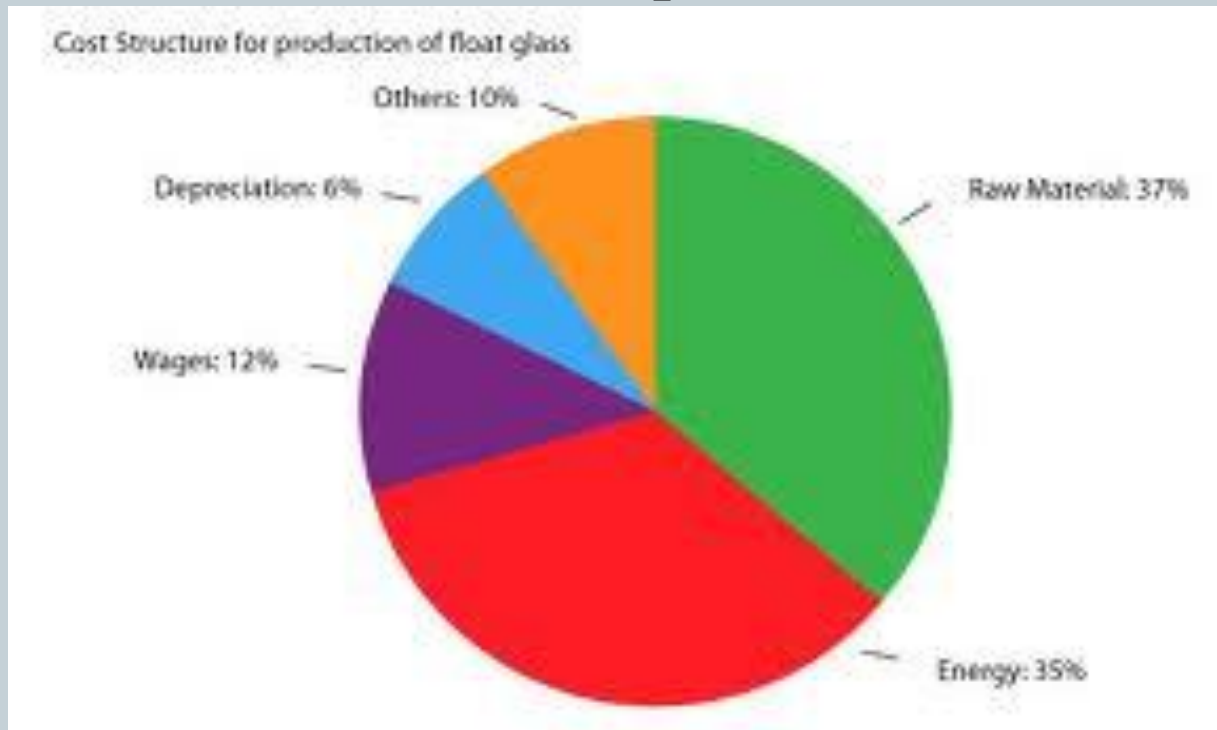
	Sole Prop.	LLC	S-Corp.
?	A business owned and operated by a single person.	A hybrid structure combining corporate and partnership features.	A corporation that elects to pass income, loss, deductions, and credits to shareholders.
+	Simplicity! Fewest legal requirements of any business form.	Flexible tax structure and limited personal liability.	Could reduce self-employment taxes by paying the owner a salary.
-	Personal liability for business debts and losses.	May be subject to state-specific franchise fees.	Can be difficult to maintain as they require similar governance to a C-corporation.

Advice #25

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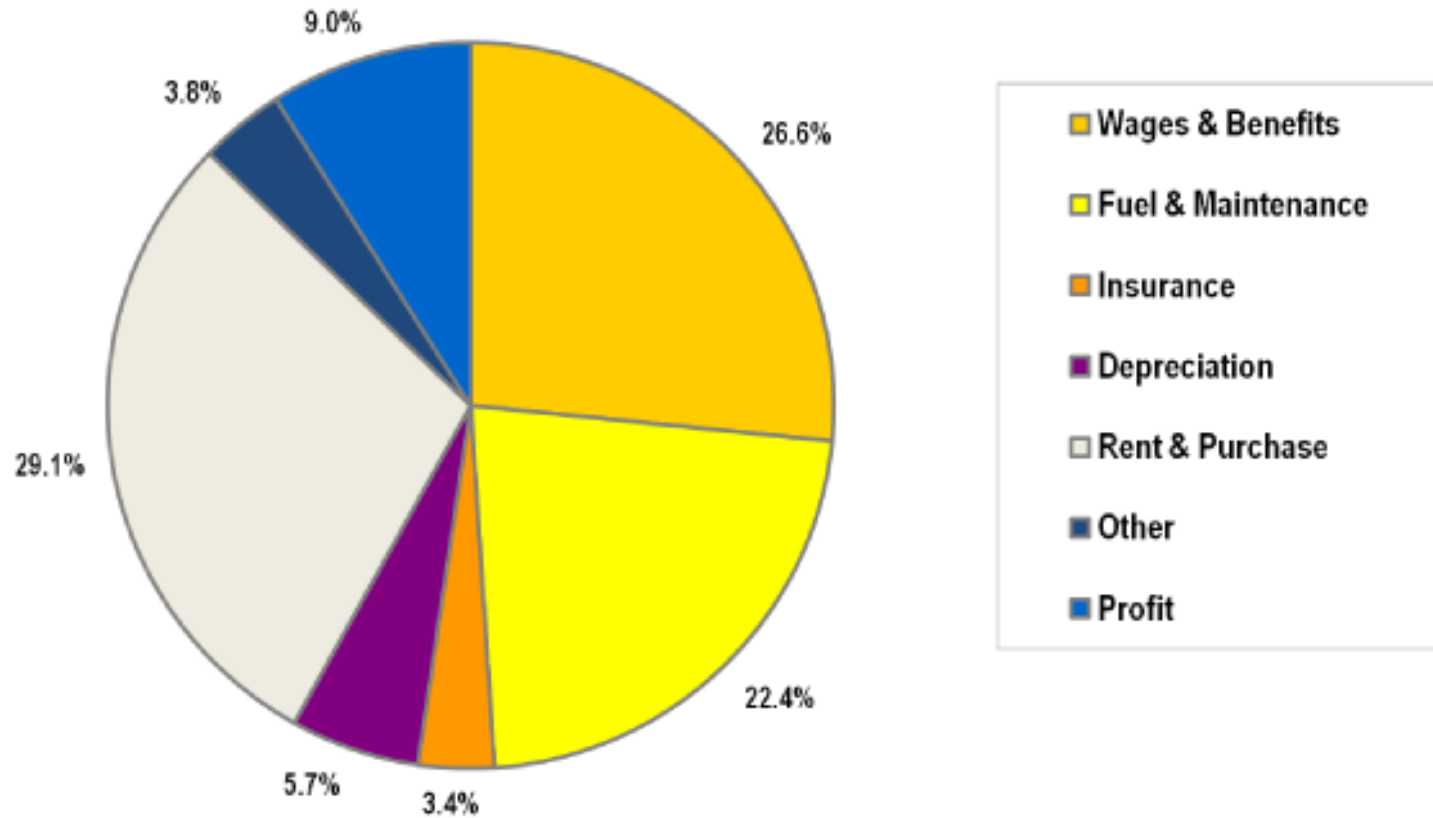
- Know, understand and manage your **cost structure**

Example



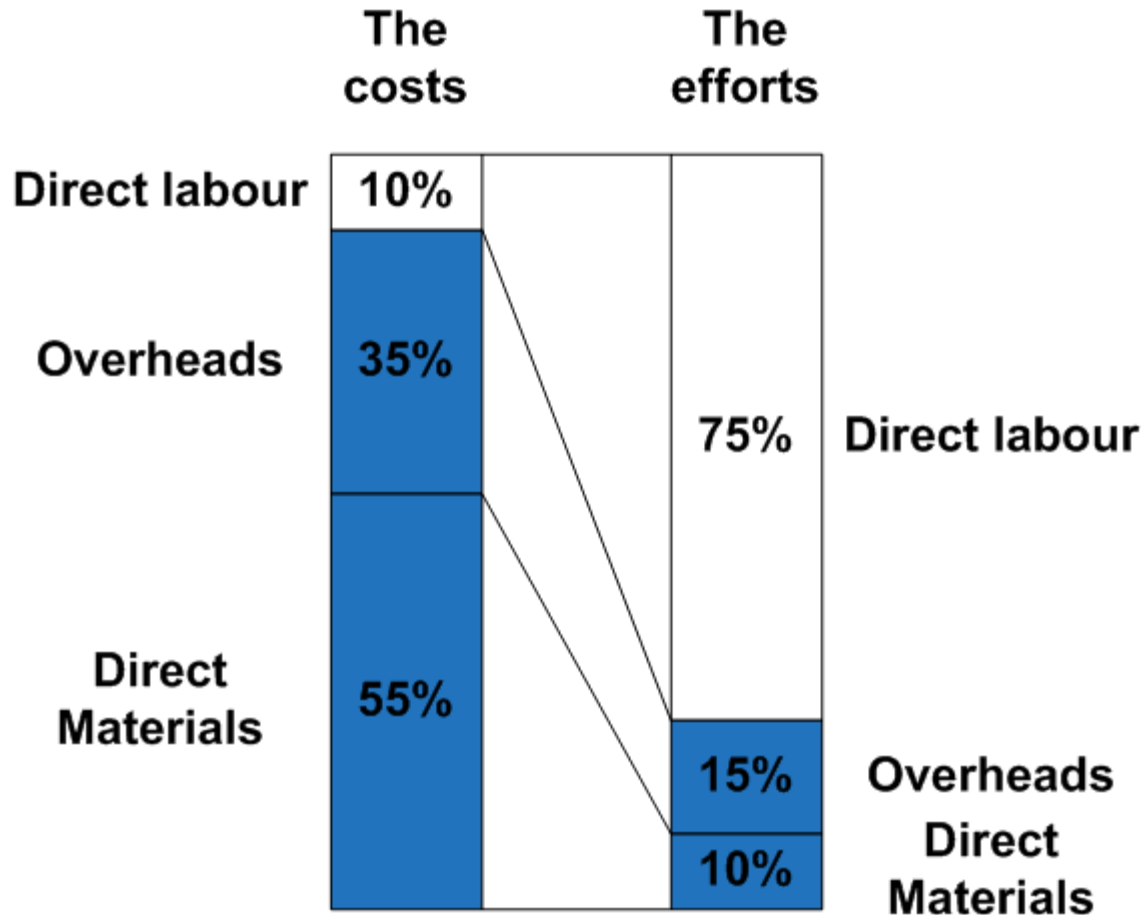
Example --- Trucking Company

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The Typical Mistake That Many SMEs Make

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They put most of their attention and effort to manage the smallest part of the cost structure: **LABOR**

Benchmark Models and Cost Structures

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	US Scenario		Mexico Scenario	
Total MWp Produced	426.624		426.624	
Total Annual sales US\$	1,109,222,400		1,109,222,400	
Sales Price US\$/Wp	2.60	%NS	2.60	%NS
NET SALES	1,109,222,400	100%	1,109,222,400	100%
MATERIAL COST	832,944,328	75.09%	832,944,328	75.09%
COST labor(800 employees)	19,088,768	1.72%	3,490,560	0.31%
General Operating Expenses	3,386,331	0.31%	3,386,331	0.31%
per Wp	200		1.97	
GROSS MARGIN	253,802,973	22.88%	269,401,181	24.29%
GENERAL& ADMINISTRATIVE	27,585,136		20,976,992	
AMORTIZATION	13,109,012		13,109,012	
per Wp	209		2.05	
Operating Earnings	213,108,824	19.21%	235,315,177	21.21%
FINANCE COSTS	2,895,653		2,895,653	
FEDERAL TAX	74,588,089		7,054,498	
per Wp	228		2.07	
Net Earnings	135,625,083	12.23%	225,365,026	20.32%

It is important to stay close to industry and/or competition's averages.

Know if outsourcing will benefit your bottom line.

*Figure 1.
Mexico vs. USA:
Business Model
Comparison
(Source: Silicon Border)*

The Average US Mfg Cost Structure

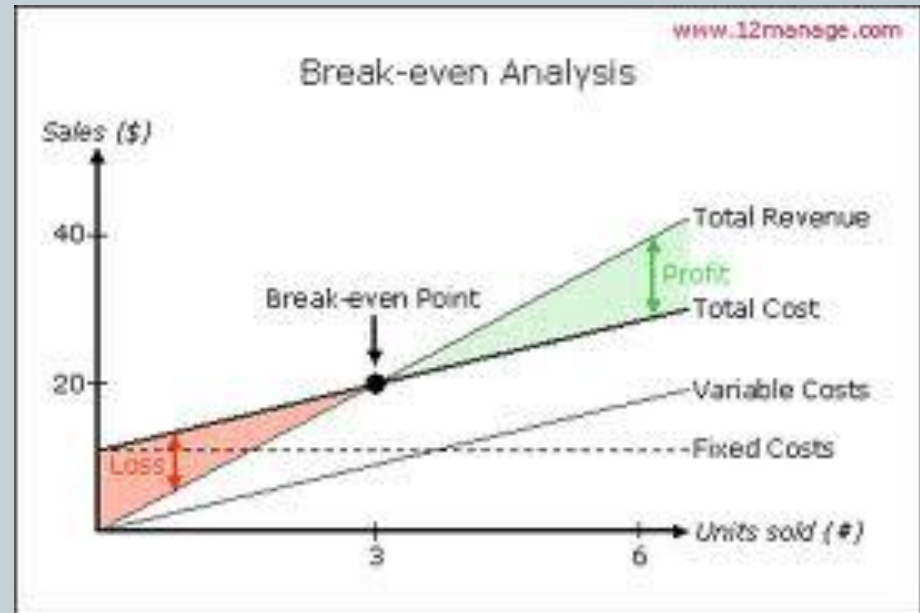
50

Raw Materials	45.98%
Labor	21.00%
Advertising & Marketing	9.00%
R&D	8.50%
Interest Expenses	3.44%
Transportation	2.90%
Health & Safety	1.60%
Energy	1.53%
Environmental	1.48%
Land & Rent	1.46%
Utilities	1.16%
Software	0.80%

Advice #26

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- Know your **Break Even Point (BEP)**



You Can Do It By Product

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$$\frac{\text{Fixed Costs}}{\left(\frac{1 - \text{Variable costs per unit}}{\text{selling price per unit}} \right)} = \text{Break Even Point}$$

Contribution Format

Sales		\$15,000
Less: Variable Expenses		
Manufacturing	\$4,000	
Selling	1,600	
Administrative	<u>500</u>	<u>6,100</u>
Contribution Margin		\$8,900
Less: Fixed Expenses		
Manufacturing	\$3,000	
Selling	500	
Administrative	<u>1,000</u>	<u>4,500</u>
Net Income		<u>\$4,400</u>

Advice #27

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- Know the **true cost of your labor** (the fully loaded (burdened) hourly rate). Labor cost is more than just direct rate and benefits



Know
what goes
into it



Field Labor Costs

	Item	Each	Per Hour
Direct Costs Weekly			
Direct Cost Per Hour Per Field Labor	\$	\$25.00	\$25.00
Hours Per Week Your Field Labor Is Paid	#	40	
	Subtotal		\$25.00
Indirect Costs Monthly			
Monthly Health Insurance Premium Per Field Labor	\$	\$600.00	\$3.46
Payroll Taxes FICA (% Of Payroll)	%	6.2%	\$1.55
Payroll Taxes Medicare (% of Payroll)	%	1.45%	\$0.36
Payroll Taxes Labor & Industries (Per Hour Of Payroll)	%	\$0.10	\$0.10
Hand Tools, Equipment Purchases, Repairs And Supplies	\$	\$150.00	\$0.87
Hourly Rate You Charge Your Customers In Your Business	\$	\$75.00	
Hours You Train, Manage And Answer Field Labor Questions	#	4	\$1.73
Cost Of Chaos / Unbilled Time / Rework / Warranty Work / Other Costs	\$	\$250.00	\$1.44
	Subtotal		\$9.51
Indirect Costs Annually			
Retirement/401k Benefits (% of Payroll)	%	2%	\$0.50
Days Of Paid Vacation And Holidays Per Field Labor Per Year	#	5	\$0.61
Hours Of Paid Time To Attend Continuing Education	#	4	\$0.05
Cost Of Continuing Education Seminars, Tutoring, Manuals	\$	\$500.00	\$0.24
Year End Bonus Paid Per Field Labor	\$	\$250.00	\$0.12
	Subtotal		\$1.02
Direct Cost Per Hour Per Field Labor			\$25.00
Indirect Monthly Costs Per Hour (Burden)			\$9.51
Indirect Annual Costs Per Hour (Burden)			\$1.02
What A Field Labor Really Costs Per Hour			\$35.53
Dollars Of Burden (Overhead On Labor)			\$10.53
Percentage Of Burden (Overhead On Labor)			42.14%
	Per Week	Per Month	Per Year
Cost Per Field Labor	\$1,421.39	\$6,159.34	\$73,912.03

Sample Fully Burdened Labor Rate Calculation

FASTER

The better management system for your fleet.

Trust us to be there.

Monthly

Payroll & Benefits	\$39,177
Supervision	\$8,457
City Overhead	\$2,350
Office Supplies	\$457
Rent	\$7,053
Utilities	\$2,814
Training	\$522
Safety	\$78
Shop Maintenance	\$1,548
Janitorial	\$2,115
Insurance	\$1,011
Rags	\$244
Inspection & Certification	0
Shop Equipment Repair	\$466
Total	\$66,292

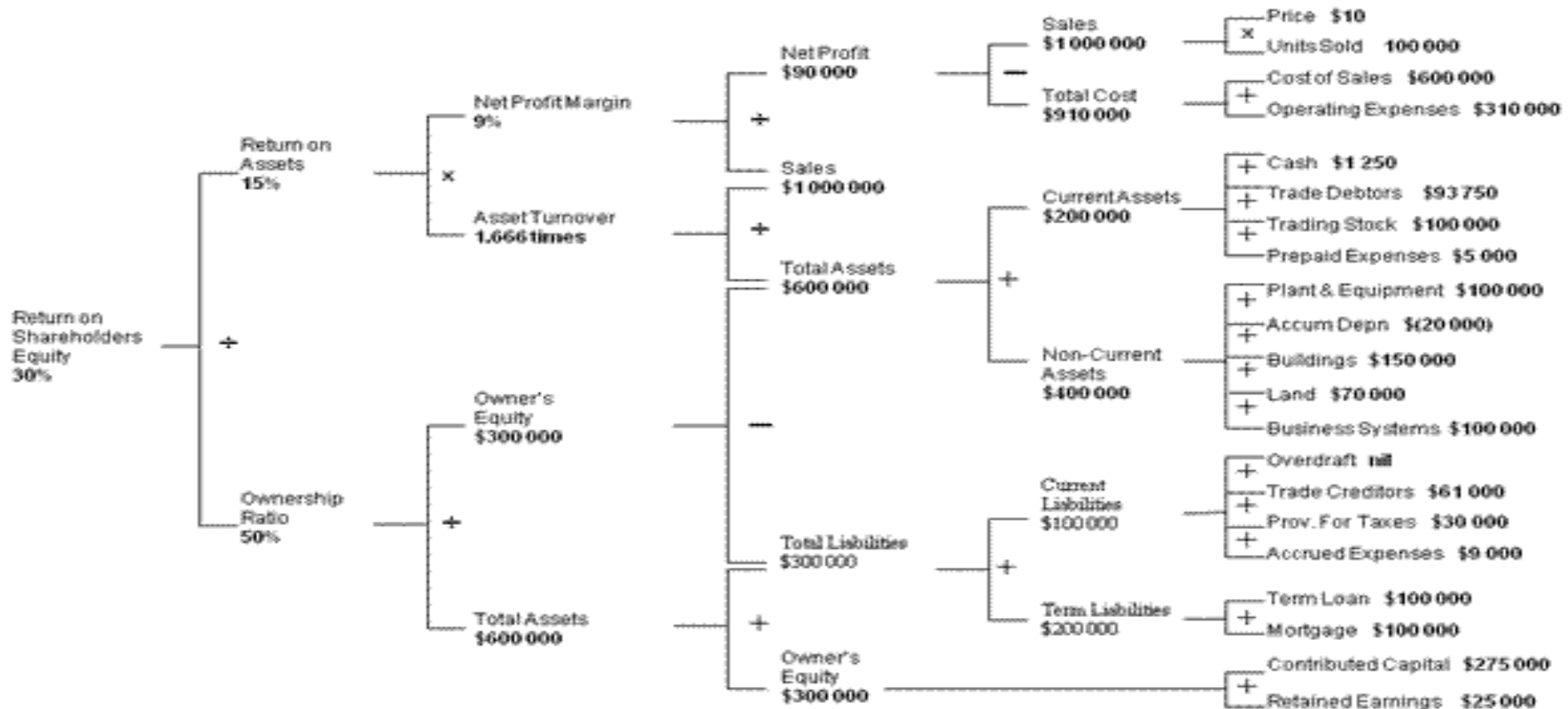
Direct Labor Hours	988
Indirect Labor Hours	385
Total	1,373

$$\text{\$ } 66,292 / 988 = \text{\$ } 67.10 \text{ Fully Burdened Rate}$$

Advice #28

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- Know your **financial ratios** and what they mean



Basic Definitions

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Activity ratios

Total asset turnover	=	$\frac{\text{Net sales}}{\text{Total assets}}$
Inventory turnover	=	$\frac{\text{Cost of goods sold}}{\text{Average inventory}}$
Accounts receivable turnover	=	$\frac{\text{Net sales}}{\text{Average accounts receivable}}$
Age of inventory	=	$\frac{360 \text{ days}}{\text{Inventory turnover}}$

Liquidity ratios

Current ratio	=	$\frac{\text{Current assets}}{\text{Current liabilities}}$
Quick ratio	=	$\frac{\text{Current assets} - \text{inventory}}{\text{Current liabilities}}$

Profitability ratios

Gross margin	=	$\frac{\text{Gross margin}}{\text{Net sales}}$
Profit margin on sales	=	$\frac{\text{Net income}}{\text{Net sales}}$
Sales to total assets	=	$\frac{\text{Net sales}}{\text{Total assets}}$
Return on total assets	=	$\frac{\text{Net income} + \text{interest expenses}}{\text{Total assets}}$

Leverage ratios

Debt ratio	=	$\frac{\text{Total debt}}{\text{Total assets}}$
Long-term debt to equity	=	$\frac{\text{Long-term debt}}{\text{Stockholders' equity}}$
Times interest earned	=	$\frac{\text{Earnings before interest and taxes}}{\text{Interest charges}}$

Financial Goals Based On Financial Ratios

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Impact of Assets, Profitability and financial ratios

Overall	Initially		Later years	
	Capitalizing	Expensing	Capitalizing	Expensing
Net income	Higher	Lower	Lower	Higher
EBIT	Higher	Lower	Lower	Higher
EBITDA	no effect	no effect	no effect	no effect
Stockholder equity	Higher	Lower	Lower	Higher
Total Assets	Higher	Lower	Higher	Lower
CFO	Higher	Lower	Lower	Higher
CFI	Lower	Higher	-	-

Liquidity ratios

Cash Flow from operation ratios

	Initially		Later years	
	Capitalizing	Expensing	Capitalizing	Expensing
	Higher	Lower	Lower	Higher

Activity ratios

Total asset turnover
Fixed asset turnover
equity turnover

	Initially		Later years	
	Capitalizing	Expensing	Capitalizing	Expensing
	Lower	Higher	Lower	Higher
	Lower	Higher	Lower	Higher

Investment ratios

ROA
ROE

	Initially		Later years	
	Capitalizing	Expensing	Capitalizing	Expensing
	Higher	Lower	Lower	Higher
	Higher	Lower	Lower	Higher

Solvency ratios

debt to equity
Time interest earned
CFO to debt

	Initially		Later years	
	Capitalizing	Expensing	Capitalizing	Expensing
	Higher	Lower	-	-
	Higher	Lower	Lower	Higher
	Higher	Lower	Lower	higher

Caution

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- Numbers by themselves do not mean anything unless they are compared to other numbers from the industry or competition

	Company	Industry (Recreational Activities)	Sector (Services)	S&P 500
Valuation Ratios				
P/E ratio, 5-yr High	48.72	34.34	31.00	22.29
P/E ratio, 5-yr Low	18.42	14.46	11.52	10.45
Beta, 5 years	0.80	1.30	1.09	1.00
Price to Sales TTM	5.21	2.80	2.44	0.29
Price to Book MRQ	39.77	6.37	5.54	3.31
Price to Tangible Book MRQ	187.51	2.35	4.99	4.80
Price to Cash Flow per Share TTM	34.30	15.76	13.00	13.37
Price to Free Cash Flow per Share TTM	55.37	16.73	21.79	19.16
Institutional Ownership Shares Owned			88.85	88.90
Dividends				
Dividend Yield			2.11	2.47
Dividend Yield, 5-yr			2.17	2.69
Dividend 5-yr Growth rate		-10.82	4.14	6.92
Payout TTM	6.80	4.15	16.45	26.10
Growth Rates				
Revenue MRQ vs. Qtr 5 Yr Ago	25.24	-27.89	5.45	16.23
Revenue TTM vs. TTM 1 Yr Ago	23.58	-37.42	-7.72	3.68
Revenue, 5-yr Growth	27.25	18.60	7.43	9.37
DPS MRQ vs. Qtr 1 Yr Ago	33.34	-14.88	6.98	23.23
DPS TTM vs. TTM 1 Yr Ago	46.49	-17.33	8.18	8.27
DPS, 5-yr Growth	45.80	5.61	9.45	11.54
Capital Spending, 5-yr Growth	-15.81	84.43	-16.78	6.32
Financial Strength				
Quick Ratio MRQ	1.56	0.24	0.66	1.17

Advice # 29

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Lower your Tax bill. There are multiple tricks



	LLC	S-Corporation
Profit Made Year 2	\$50,000	\$50,000
Dividends	none	\$20,000
Net Salary	\$50,000	\$30,000
Income Tax @ 30% Rate	\$7,500	\$4,500
Money Saved in Taxes		\$3,000

Here Is The Most Popular Way To Lower Taxes

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	Regular Owner	Smart Owner
Revenue/Income	\$30,000	\$30,000
Deductions	None	See lines below
Business Trips/Vacation		\$2,000
Children on Payroll		\$4,000
Automobile		\$4,000
Office in Home		\$5,000
Entertainment		\$1,500
Equip. Purchases		\$4,000
Misc. Biz Expenses		\$1,500
Adjusted Gross Income	\$30,000	\$8,000
Federal Tax (on Income)	\$2,800	\$0
Social Security Owed	\$2,250	\$1,200
Total Owed The Government	\$5,050	\$1,200
Taxes Saved	\$0	\$3,850

Other Deductions

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- Charities
- Education and Training
- Tax preparation fees
- Investment related expenses
- Losses due to theft
- Uncollected debt
- Certain taxes
- Certain business equipment
- Certain energy tax credits, and many more

Caution

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- Do NOT depend on your CPA as a tax preparer to tell you all the ways to reduce your tax bill. Become smart about taxes on your own
- Most CPAs are NOT experts in Managerial Accounting. They know Financial Accounting. The difference between the two is huge
- Most CPAs at tax time work 60+ hours per week with scores of clients. Their main concern is to be accurate because they are afraid of the Government that can levy heavy financial and criminal penalties against them

Reminder

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- No tax preparer can help you or save you any money in taxes after the 1st of the year. So learn how to save on your taxes throughout the year



Advice #30

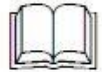
65

- Utilize **Managerial Accounting** to manage your business

Financial Accounting:



Records transactions



Classifies transactions



Reconciles records

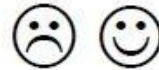


Summarises transactions



Presents financial data

Management Accounting:



Compares results against goals



Determines reasons for variations



Helps identify corrective action



Forecasting & planning



Analyses information

Financial Accounting

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- Reports to those outside the organization owners, lenders, tax authorities and regulators
- Emphasis is on summaries of financial consequences of past activities
- Objectivity and verifiability of data are emphasized
- Precision of information is required
- Only summarized data for the entire organization is prepared
- Must follow Generally Accepted Accounting Principles (GAAP)
- Mandatory for external reports

Managerial Accounting

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- Reports to those inside the organization for planning, directing and motivating, controlling and performance evaluation
- Emphasis is on decisions affecting the future
- Relevance of items relating to decision making is emphasized
- Timeliness of information is required
- Detailed segment reports about departments, products, customers, and employees are prepared
- Need not follow GAAP
- Not mandatory

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