

Understanding SMEs and Their Business Environment

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PHIL ANDREWS

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PART 2



First, The Good News

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- Large corporations have the benefits of mass/scale, deep pockets, easier ways to raise funding, borrowing at better rates, more influence in Washington, bailouts, better training and better employees. However, SMEs have their own advantages, such as: owners' motivation, better service that thrills and enthuses customers, better quality products, quicker to react to opportunities, quicker to recognize trends, quicker to change plans and directions, keener in understanding customers needs and wants and smarter in creating customer loyalty

SMEs Can Be More Profitable Than Big Corporations

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- Here are some examples:

Industry	ROI for Big Corp	ROI for SME
Food	12.6%	25.7%
Fuel Distribution	12.1%	74.9%
Retail	12.5%	45.0%

This is the number one reason for Outsourcing. Profitability matters. Thus, big corporations want to work with SMEs and in some cases sell franchises . SMEs bring more than profits to the table. They bring drive and enthusiasm that are typically missing in big enterprises

Key Realization

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- 89% of the people that made over \$50K per year were owners of SMEs, according to the IRS
- More than 85% of all small businesses show a profit, according to Harvard Business Review



Gains At The Personal Level

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No of months after leaving job	Personal Income Increase (after expenses)
1.5 months	65%
3 months	100%
7 months	150%

Source: Howard Shenson

Biz Smarter Free Course

Almost Unbelievable

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- In times of uncertainty and rapid economic, social and technological change (which is happening right now) great opportunities are generated for would-be entrepreneurs. The number of millionaires has been growing 3X the GDP and a new millionaire is “born” every 39 minutes

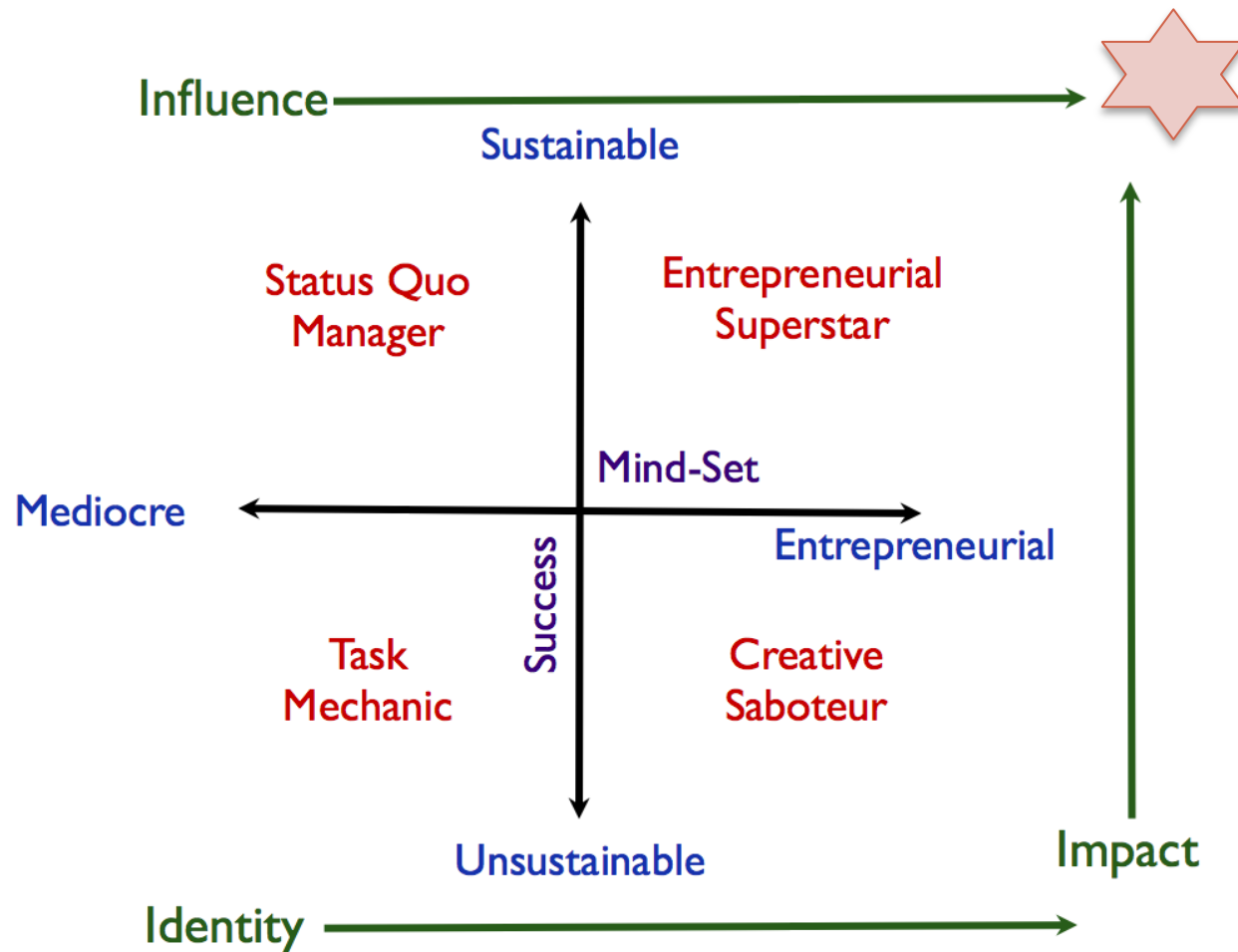


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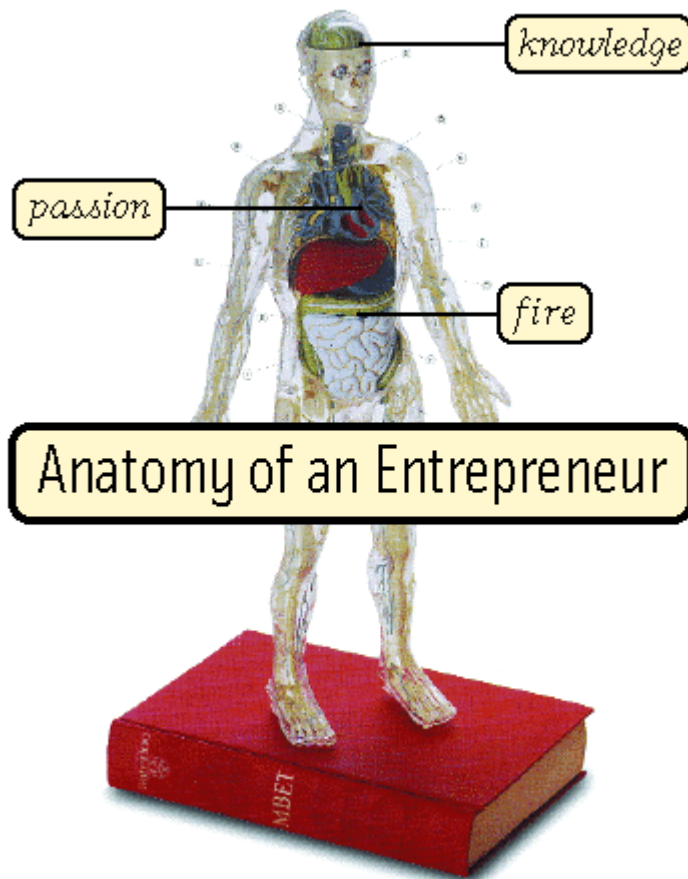
Another Way To Understand The Mind Of The Entrepreneur

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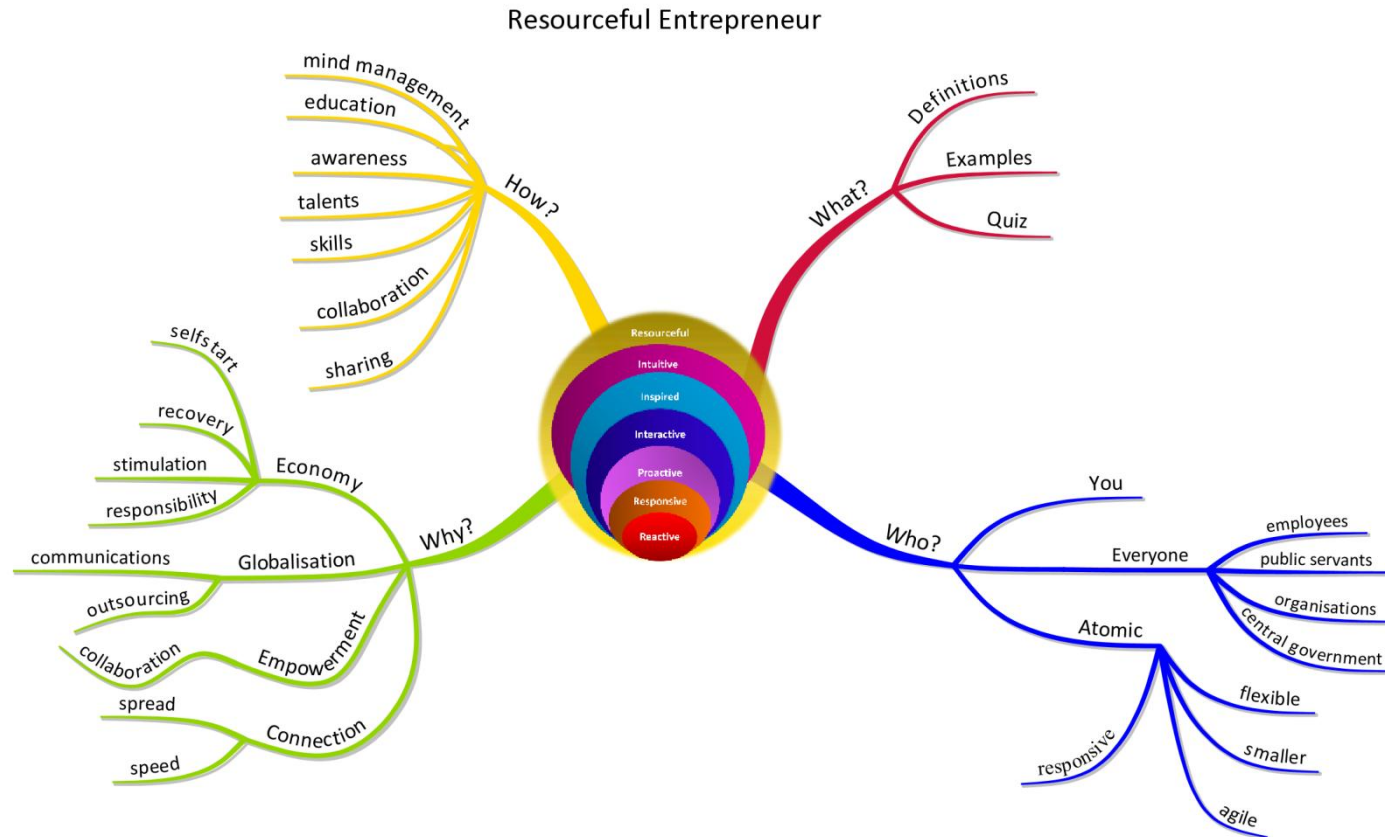
And Here Is The Anatomy

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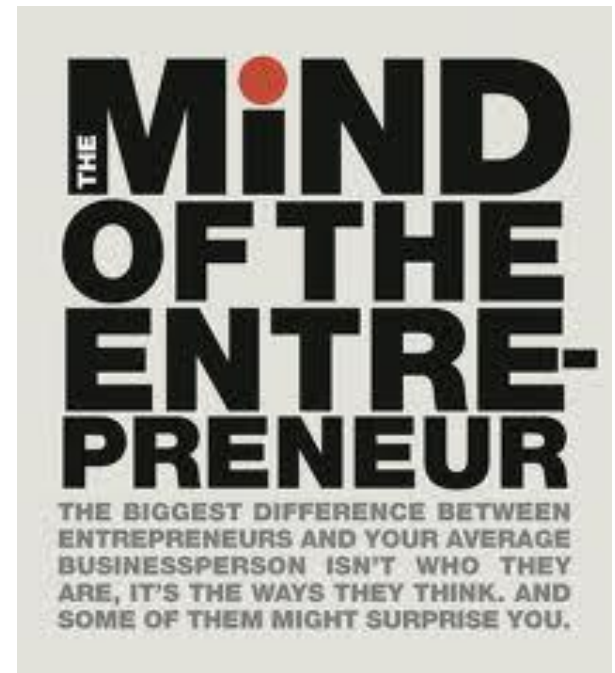
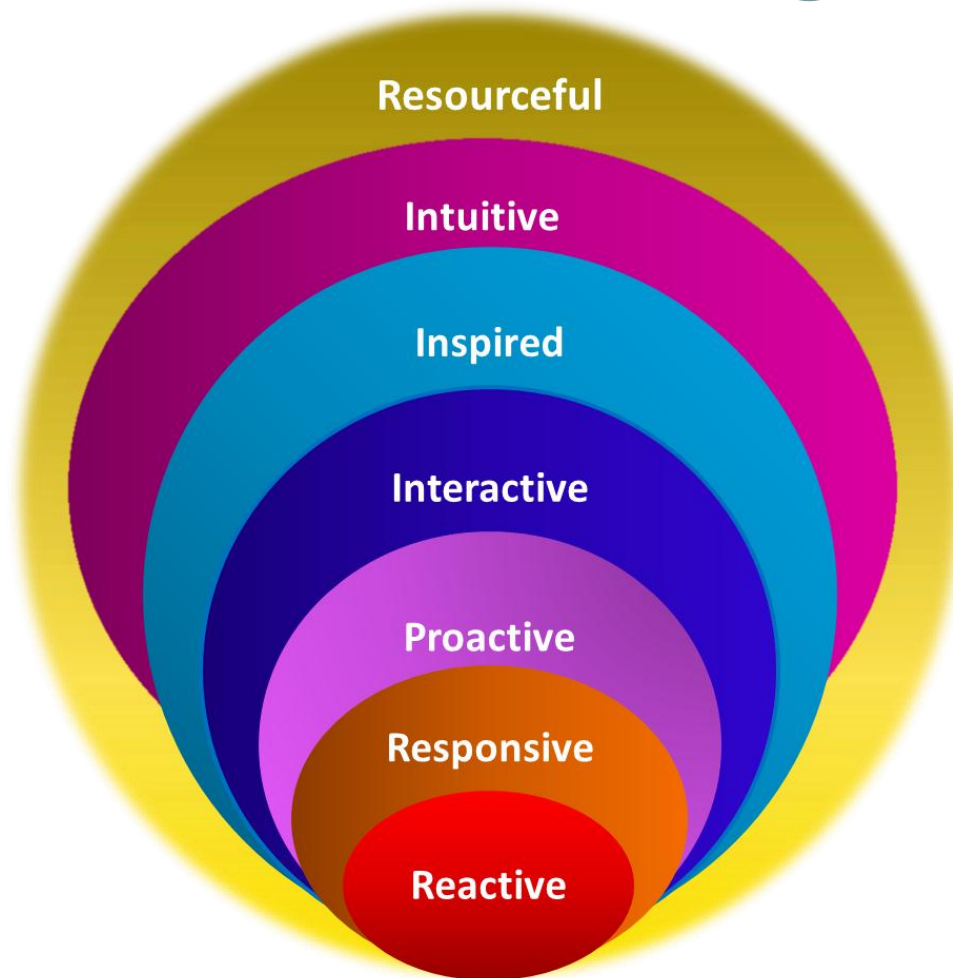
How, What, Why, Who

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So, Who Are You?

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Addressing The Achilles' Heel

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LACK OF KNOWLEDGE

The Fundamental **Flaw** is
Ignorance



A lack of
Information & Knowledge

Let's Test Your Knowledge

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Question	True	False
Should you hire your in-laws in your business?		
Should you place your picture in your ad or website?		
Should you advertise in the Yellow Pages?		
One cannot save money on taxes since the tax law was made tougher		
The only way to make big money is to have a “hot” idea or a “hot” business?		
Are banks the best place to borrow money to expand your business?		
Is pricing of a product or service an art (rather than science)?		
Is it necessary to open your business as close to home as possible?		

The Answers To The Quiz

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- All answers to the questions are FALSE or NO

The Consequences of Lacking Knowledge

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- Costly mistakes
- Repeat of mistakes
- Bad decisions
- Taking unnecessary or harmful risks
- Losing credibility and trustworthiness with employees
- Losing the trust of customers and suppliers
- Missing on opportunities
- Unable to invent, innovate, improve

Here Is Another Quiz

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- Which one is more important?
 - Operational/Production problems and issues
 - Marketing and Advertising related problems
 - Administrative/Management related problems

The answer is found in the next five pages.

Key: **O** is for Operational
M is for Marketing
A is for Administrative

Let's Address The Biggest Problems Of Starting An SME

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O	M	A	Pitfall or Problem
		X	Owner's personal characteristics (demeanor, energy, attitude, will, ...)
	X		Poor choices of opportunity (no market research)
		X	Inadequate starting capital
		X	Too much investment in non-critical assets or wrong things
	X		Emotional selection of location
		X	Emotional selection of management team
	X		No understanding of customer needs and wants
	X		No knowledge of attracting customers

Let's Address The Biggest Problems Of Starting An SME (cont'd)

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O	M	A	Pitfall or Problem
		X	Failure to seek professional advice from consultants, CPAs, attorneys, etc.
		X	Poor choices of legal form (sole proprietorship, partnership, corporation)
		X	Insufficient experience in products/services offered
		X	No comprehension of business models and how they work
		X	No business experience or skills
		X	Insufficient Planning (incl. incomplete Business Plan, lack of other plans for Ops, Marketing, etc.)

Let's Address The Biggest Problems Of Running An SME

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O	M	A	Pitfall or Problem
		X	Lack of Planning (lack of targets, goals, BEP, performance levels, etc.)
		X	No knowledge of handling finances and recordkeeping
		X	Carrying inadequate inventory
		X	Unable to cover payroll and taxes
	X		Poor credit granting to customers (A/R problem)
	X		Emotional pricing (undercharging problem aimed at beating competition w/o regard to value, image and brand)

Let's Address The Biggest Problems Of Running An SME (cont'd)

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O	M	A	Pitfall or Problem
		X	Living too high for the business (bad spending habits aimed to impress others and self)
		X	Expanding too rapidly
		X	Insufficient experience in products/services offered
	X		Wasted advertising dollars or total lack of advertising (wrong channels, media, etc.)
		X	Inadequate borrowing practices
		X	Bad investments in operations
		X	Bad management practices -- high employee turnover

Conclusion

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- As one can see from the last four pages not one of the pitfalls or problems (for either starting or running a business) has to do with Operations/Production And yet that is where most Business Owners and executives put most of their attention and energy. The major underlying problem is lack of knowledge and understanding of what it takes to run a business

**Not having this knowledge guarantees failure.
Having this knowledge almost guarantees
success!**

Some Key Facts

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- 1/3 of new businesses will fail within months
- 75% of startups shut down within 5 years
- 9 out of 10 companies operating today will eventually fail, or just give up trying



Key Question

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- On slide 4 the claim was made that 85% of SMEs are profitable, so how can they be failing at these astonishing rates?
- Because failure is not about profits alone. Moreover, profits can disappear overnight. One wrong move or decision can wipe out the entire business. Most business owners and execs do NOT understand that every decision matters



Sad Reality

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- If not properly and legally protected you can lose everything, incl. your car, your house, your life savings, your furniture and everything else that has value



Why So Many Businesses Fail?

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- On top of all the pitfalls, drop doors and business problems, most business of all sizes have hard time mastering all aspects of the business. It is very hard to create the perfect management team that knows it all and can handle it all. As was mentioned earlier, too many owners and executives fly-by-the-seat-of-their-pants, improvising, guessing, winging it, taking foolish risks and making absurd decisions based on gut feeling rather than properly researched and analyzed information

Businesses of All Sizes Fail

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- Penn Central and 100+ other transportation cos
- Pan Am, TWA, Braniff, Eastern and many others
- Washington Mutual and thousands of other banks
- Countrywide, Lehman Brothers
- McDonnell Douglas and 49 other A&D companies
- ENRON, Wang, Digital, Compaq, EDS, LTV Steel
- Woolworth, Arlan's, Border's and other retailers
- Arthur Andersen and thousands more consulting firms

These Companies Lost Their Leadership Position

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- Barnes and Noble
- Bank Of America
- CITICORP
- Dell
- ZYNGA
- Sears
- J.C. Penney
- Groupon
- My Space
- NY Times
- American Airlines
- AOL

Companies Predicted to Fail In The Next 24 Months (2013 -2014)

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- RIM (Blackberry)
- Pacific Sunwear
- Ericsson Cell Phones
- Nokia
- A&W
- American Apparel
- Saab
- Kodak
- Several newspapers

In 2009 207 major companies went bankrupt (per Forbes magazine)

Giants That Are Shrinking

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- GM
- BoA
- CITI
- AIG
- Motorola
- Time Warner
- Home Depot
- Sprint
- NASA

The risk of failure is greater now, than even before. Because we live in a hyper-competitive and global environment!!!

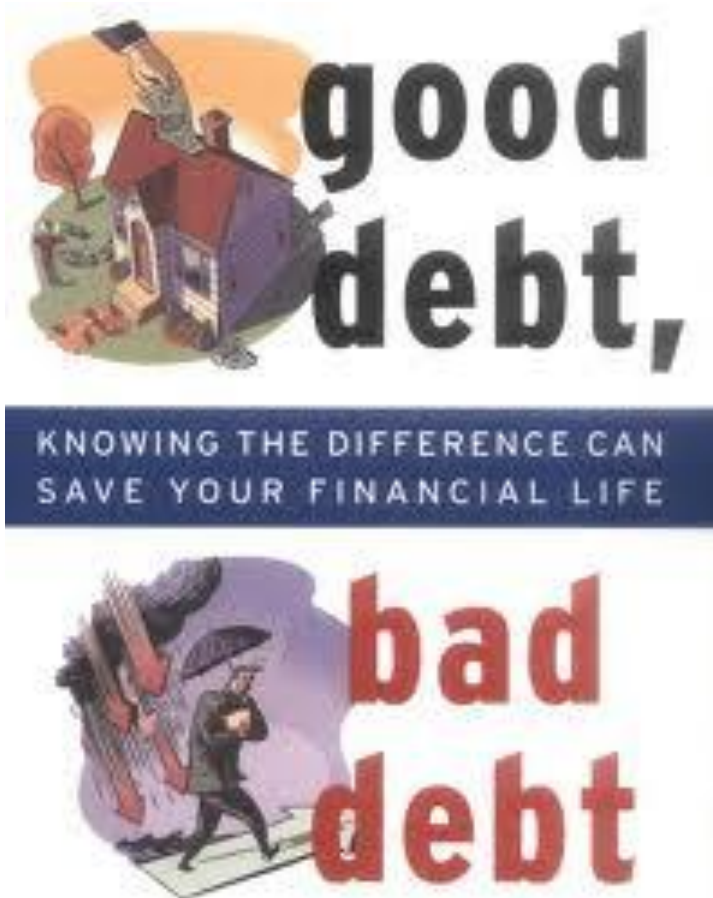
Major Revelation

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- Most business owners do not know how to read and extract useful information for their own business from:
 - Profit & Loss Statements
 - Balance Sheets
 - Cash Flows
 - Inventory Levels (Raw, WIP and Finished Goods)
 - A/R Backlog
 - Debt Type and Level
 - Payroll and Benefits

Do You Know The Difference?

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Do you know the limits (when too much is too much)?

Even Something As Simple As This It Is Confusing To Them

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Performance Measurement System and Key Financial Ratios



An Example From Adidas

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Key Financial Metrics - 2005 Results

Gross margin	$= \frac{\text{Gross profit}}{\text{Net sales}} \times 100$	= 48.2%
Operating expenses (% of net sales)	$= \frac{\text{Operating expenses}}{\text{Net sales}} \times 100$	= 38.2%
Operating margin	$= \frac{\text{Operating profit}}{\text{Net sales}} \times 100$	= 10.7%
Average operating working capital ¹⁾ (€ in millions)	$= \frac{\text{Sum of operating working capital at quarter-end}}{4}$	= 1,819
Operating working capital ²⁾ (% of net sales)	$= \frac{\text{Average operating working capital}}{\text{Net sales}} \times 100$	= 26.0%
Capital expenditure ¹⁾⁽²⁾ (€ in millions)	= Additions of property, plant and equipment plus intangible assets	= 211

1) Including discontinued operations

2) Excluding goodwill and financial leases

The Best SME Measurement For Success Is:

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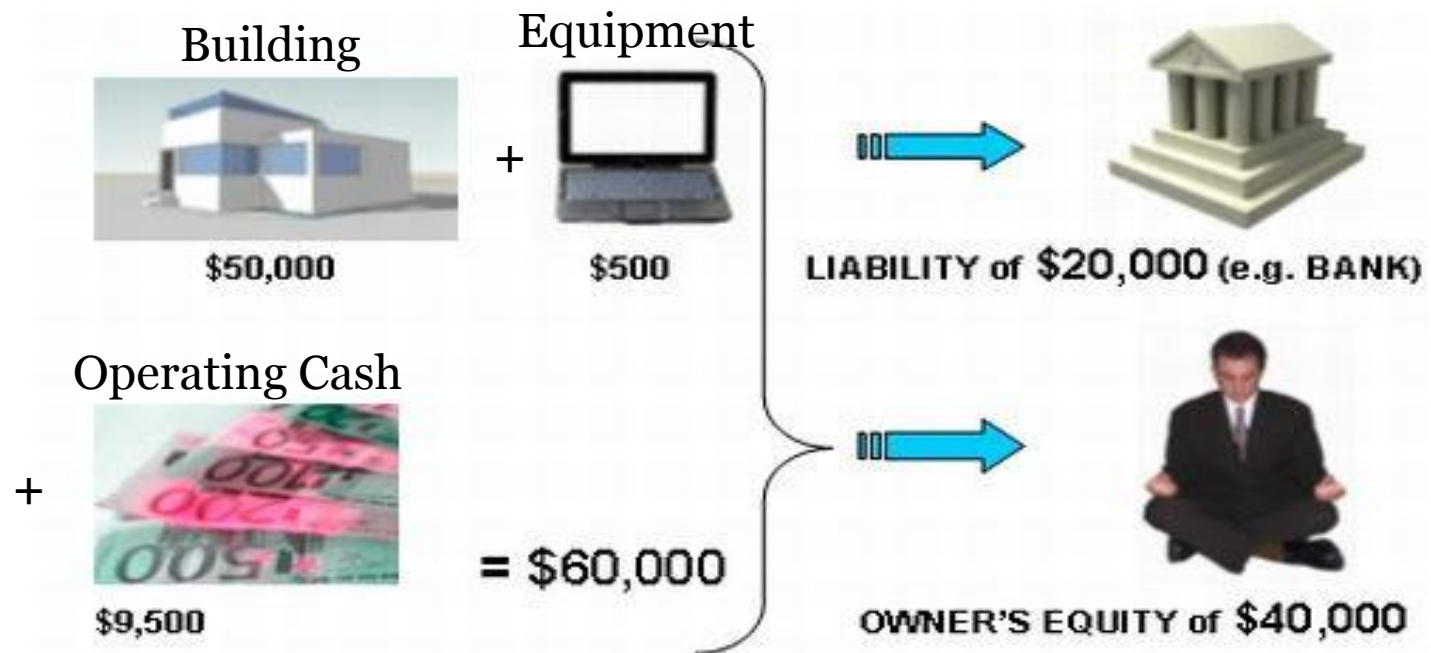
$$\text{ROI} = \frac{\text{Net Profit (Return)}}{\text{Owner's Capital (Equity)}}$$

Your business should offer a satisfactory return (on investment) just like stocks, bonds, real estate, savings account, or any other investment. If the ROI is not good then the business is in trouble

Owner's Equity (Investment In The Business)

Example

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Owner's equity is officially defined as:

...the residual interest in the assets of the enterprise after deducting all its liabilities.

The owner's equity is simply the owner's share of the assets of a business.

Can You Complete This For Your Company?

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OPENING DAY BALANCE SHEET FOR ABC COMPANY									
CURRENT ASSETS					CURRENT LIABILITIES				
Cash					Accounts payable				
Receivables					Short term notes payable				
Inventory					Current portion LTD				
Prepaid Expenses									
TOTAL CURRENT ASSETS					TOTAL CURRENT LIABILITIES				
LONG TERM ASSETS					LONG TERM LIABILITIES				
Land					Term loans net of current portion				
Vehicle					Loans due shareholders				
-accumulated depreciation					Other long term debt				
Net Vehicle					TOTAL LONG TERM LIABILITIES				
Equipment					NET WORTH				
-accumulated depreciation					Common Stock				
Net Equipment					Retained Earnings				
TOTAL OTHER ASSETS					NET WORTH				
TOTAL ASSETS					TOTAL LIABILITIES & EQUITY				

Calculate Your ROI

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$$\text{ROI} = \frac{\text{Net Profit}}{\text{Owner's Capital (Equity)}} =$$

Other Ways To Calculate Your ROI

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$$\text{ROI} = \frac{(\text{Gain from Investment} - \text{Cost of Investment})}{\text{Cost of Investment}}$$

$$\text{Average ROI} = \frac{\text{Average operating income}}{\text{Investment}}$$

$$\begin{aligned}\text{ROI} &= \frac{\text{Net Profit After Taxes}}{\text{Total Assets}} = \frac{\text{Net Profit After Taxes}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Total Assets}} \\ &= \text{Net Profit Margin} \times \text{Total Asset Turnover}\end{aligned}$$

What Makes The Difference In ROI?

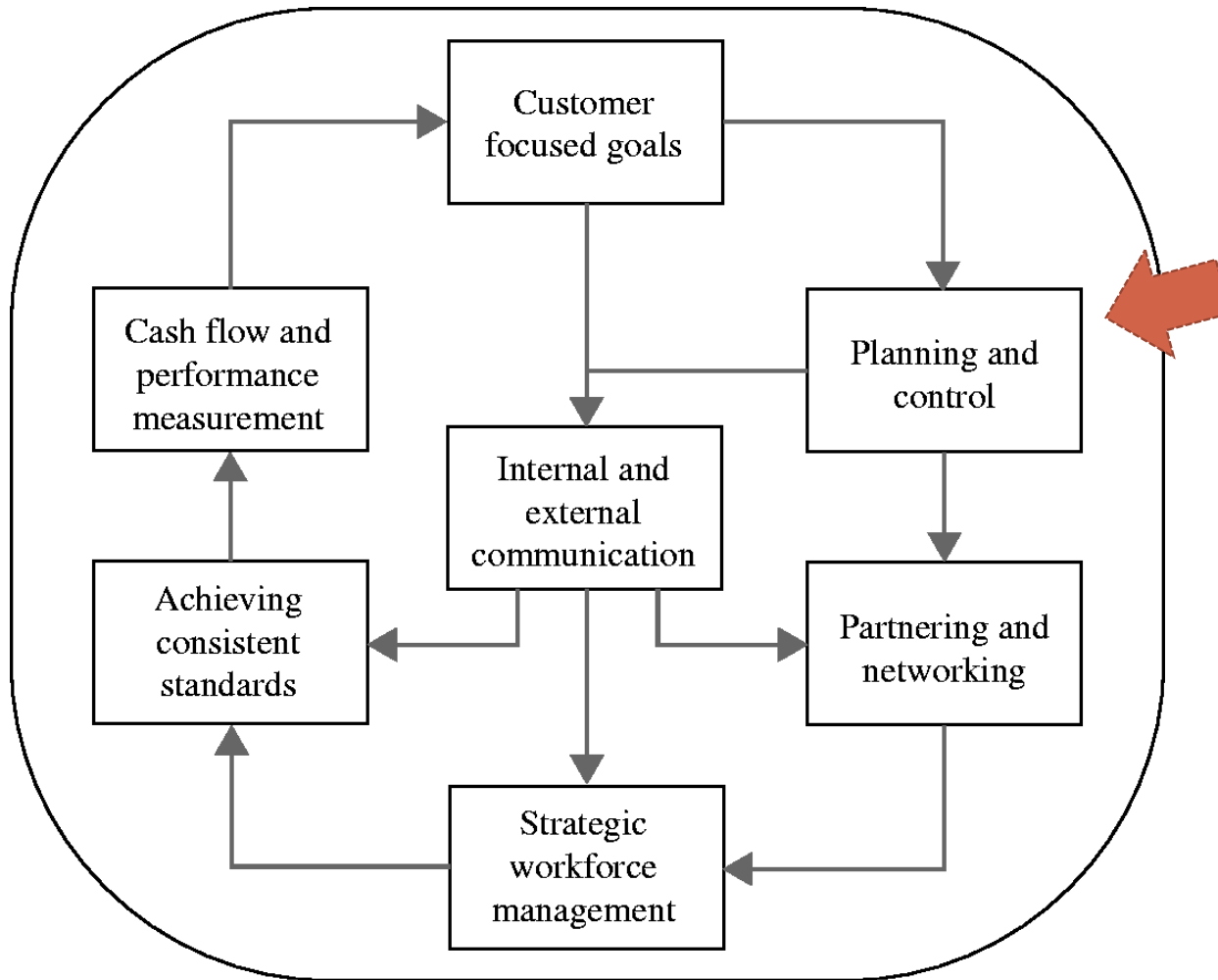
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Poor ROI	Type of Business	Great ROI
7.1%	Children's Clothes Manufacturing	32.8%
11.7%	Electronic Parts Wholesale	51.7%
6.8%	Sporting Goods Retail	38.7%
4.0%	Auto Parts Service	53.4%

Good Management makes all the difference

Good Management Is Anticipatory Management

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Strategy



Do You Know The Difference Between Bad And Good Management?

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	Bad Management	Good Management
Vision	None	Always
Planning	None	Always
Communications	One sided and fragmented	Bidirectional and continuous
Meetings	Rarely having formal mtgs	Having regular meetings
Decision Making	Top-down mandated	Participatory and collective decision making
Delegation	Limited to none	Extensive
Empowerment	None (micromanagement)	Properly empowered
Style	Dictatorial/Authoritative	Coaching/Mentoring
Overall Energy	Negative	Positive
Mode	Crisis Management	Proactive/ Anticipatory Mgmt

Key Realization

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- Most SMEs operate under the **Crisis Management** model, not realizing that it costs them plenty of money and frustration



Not Too Far From Reality

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"...and so it's agreed, in order to sharpen our crisis management skills, we're enrolling in an apology workshop."

How To Exit The Crisis Mode

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Start With A Good Strategy and Stick to It

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- The key is to have a vision for the company
- Translate the vision into goals and objectives
- Then figure out the actions required to meet those goals and objectives
- Translate the actions into programs and/or projects
- Figure out what it will take and what it will cost to execute those programs and projects
- See those programs and projects through. Make sure that their execution matches the plan

Strategy Does Not Have To Be Complex Or Exotic To Have or To Offer Value

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Here Is Another SME's Strategy

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- **Appreciation** – appreciating the value of the business continuously. Keep adding value. Put more emphasis on value multipliers
- **Capital Raising** – expanding the capital base of our business. Investing in the business
- **Optimization** – making the most of the business, its assets, resources and opportunities
- **Growth** – growing the business daily
- **Diversification** – Creating new revenue streams
- **Acquisition(s)** – growing the business by acquiring another business or two (preferably competitors)
- **Exit** – Selling our business at the right time and maximizing our wealth creation

So, What Is Your Vision?

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What Are Your Main Goals That Will Support The Vision?

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Ready To Move To Part 3

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Helpful Advice

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