**10 deadly sins for an SME\* Business**

This extract outlines commonly revealed mistakes made by small businesses resulting in them making little or no money, ever!

1. **Profit calculation – no understanding of the profit equation**

The first trap is not being able to properly calculate profit. As a result errors are made when pricing goods and services. This might be discovered by the external account when looking at the business performance ratios, typically when the statutory accounts are being done for filing and tax purposes. Has your Accountant said anything? Ask to see the ratios analysis. Ask questions about them.

**Sales Income** *less* [**uncollectable debts**] *less* **COGS [ production related costs** *less* **obsolete stock** *less* **all expenses relating to the business in the correct reporting period]** equals **Trading Profit.**

Having established what the trading profit is as a ratio of sales revenue, for pricing purposes this can be used as an input to determine how much margin / gross profit is required for a product or service. As a ratio of sales revenue, needs to be produced by the SME to make the desired trading profit.

For example – if an SME wants a trading profit [NPBT – net profit before tax], of 10%, and they use a cost plus methodology to establish prices, then the SME would be wise to understand how pricing actually works and what the SME’s breakeven point is. [See 3].

Lesser trained folk give away too much discount in negotiations because they do not realise operating on a 10 % profit [NPBT] really isn’t much to come and go on, giving a 10% discount on an invoice most likely wipes out the profit.

1. **Poor accounting support & accounting system set up**

An SME typically uses an external Accountant to produce and file the annual statutory accounts, so that the firm is compliant with ASIC, ATO etc. If the SME is using an accounting package like XERO, then the external Accountant most likely has had some input into the creation of the Chart of Accounts [the backbone of the reporting methodology in an accounting system]. However few if any Accountants explain to their customers what the SME can use the accounting system for other than entering cost based data collection for financial reporting purposes. Recently Accounting firms began to sell Xero type accounting systems to their Clients – as a method of automating data capture for the Accountant [So that the Accounting Firm was getting more accurate and better information – which they need], and to streamline the production of the annual accounts. Most accountants see themselves as the Referee, not the Coach, however organisations such as the CPA are encouraging their members to go beyond compliance reporting and get involved in their clients businesses and assist them understand what lies within the numbers, and how to improve performance.

A lack of basic book keeping can be an issue:

* 1. Cash v Accrual accounting [[https://www.investopedia.com/ask/answers/09/accrual-accounting.asp]](%5bhttps:/www.investopedia.com/ask/answers/09/accrual-accounting.asp%5d)
  2. Perpetual v Periodic inventory treatment [ <https://www.accountingtools.com/articles/what-is-the-difference-between-the-periodic-and-perpetual-in.html>]
  3. Poor stock management: Not taking into account spoilage, theft, shrinkage and obsolescence.
  4. No benchmarks: Budgeting and cash flow reporting
  5. Poor accounts receivable methods: failing to chase up money owed to the business in a reasonable timeframe. Then failing to adjust the receivables ledger for monies that most likely are uncollectable because the debt is probably unrecoverable [ Doubtful or Bad Debt]

All of the above [A to E] have an impact on the profitability. Unfortunately it’s not until the end of the year when the external accountant produces the Profit and Loss, in a ratio format [i.e. NPBT is X % of overall sales revenue] do the Owners realise their years efforts have not amounted to much in the form of a financial reward. Additionally they have a problem where they have priced their products or services too cheaply.

The SME Owner doesn’t have to become an Accountant or Book Keeper, but they might want to understand whether they are work for love or money.

1. **Break Even Point**
2. **I’m an entrepreneur [without a plan], I’ll wing it!**
3. **Strategy is the last thing we need**
4. **Technology is racing away at such a pace we cannot keep up**
5. **Information is key, we don’t seem to have any**
6. **Delegation is hard, especially if there is no one else**
7. **Getting out is worse than getting in – where’s the exit hatch ?**
8. **Seduced by fake news**

**O & A 10 business basics – need to know.**

1. Understand Profit – learn how to produce and read a profit and loss report. Understand the main aspects of cost of goods, margin [gross profit], expenses and profit.
2. A = L + O E. Memorise and learn off by heart. It means, assets equal liabilities plus owners’ equity. Assets [what something is valued at] *equals* what is owed / mortgaged against it *plus* what already has been paid off/is owned.
3. Margin is not mark up. Understand the difference. A 50% mark-up is a 33% margin.
4. Breakeven means no profit. Learn the difference between fixed cost and variable costs. Understand how to recognise breakeven from a units and dollars perspective.
5. Websites matter. For most businesses websites are the first line of offense in firing a marketing shot to capture customers. Websites need to talk to the target markets in the language they understand.
6. 80% of businesses fail within 3 years and take the family house with them down the drain. Lenders are only too willing to extend against the mortgage head room on a house valuation. The business venture’s income MUST pay the mortgage – first and foremost before anything else. If it cannot it’s not a business with a proper business case but a lottery.
7. Understand cash flow and how it is calculated, understand the timing of paying and being paid.
8. Determine what capital expenditure is and how it is treated from an expense perspective, specifically understand what depreciation is.
9. Learn about accruals – effectively accounting for future costs, as distinct from cash accounting. Reporting monthly profitability using accrual accounting will look dramatically different from cash accounting
10. Make new customer sales constantly, even if the business is already stretched. Markets and customer behaviours move continuously. Very quickly entire market segments disappear and business owners claim they didn’t see it coming, because they were serving traditional customers, who may have moved from working into retirement, so they do not need new business suits any more, the last one bought will do for formal occasions.