4 FATAL MISTAKES MADE BY BUSINESS OWNERS

Why many businesses fail and how to avoid it

For Business Owners of SMEs

JORGE COLIN

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For all those entrepreneurs who are struggling with their business, hoping this book will give them clarity on how to fix their profitability problems and ignite their entrepreneurial spirit again.

About the Author

Jorge Colin is the founder and President of Money Pitfalls, LLC, an innovative business consulting firm established in Miramar, FL. He worked for several years as Director for Woodbridge International, a US M&A firm located in New Haven, CT. Previously, he worked for 20 years at senior positions in the Banking Industry in Mexico.

Mr. Colin holds an Industrial Engineering Bachelor and an MBA degree. He also took a Harvard-like program for senior executives at IPADE Business School.

He has helped small and mid-size companies to improve their profitability by finding their weak points and advised business owners and CEOs on how to fix them. Mr. Colin developed innovative proprietary financial models to make a deep analysis of companies in the manufacturing industry to help business owners find and solve their liquidity and profitability problems.

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"50% of new businesses fail within the first 5 years, and about 90% fail after 10 years."

Do you wonder why this happens?

How is your business performing?

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INTRODUCTION.

“The first step in solving a problem
is to recognize that it does exist”

- Zig Ziglar

Introduction

I know smart business owners who have been managing their company for many years now and who still complain about its bad results. They seem to suffer with his business rather than enjoying it. Sometimes, their problems are the same one's year after year, but they have not been able to fix them so they have gotten used to live with them. They stopped looking for solutions and have accepted a low profitability as normal even though they know deep inside that their business is underperforming and that they could do something to make it more profitable.

Let me tell you about my friend Charlie, a second-generation owner of a furniture manufacturing company. His father started the company in 1960 manufacturing metal bunk beds. After only a few years, he made it a very profitable business and was recognized as an important local and regional player.

Now, the company is managed by his son Charlie but, differently from the bright years of the past, the company has been operating practically at break-even level for several years. Charlie is concerned about the profitability of his business and have unsuccessfully tried different approaches to improve their profits. But, since he earns a good salary and collects a monthly lease for the manufacturing building he owns, he feels okay. He is not happy with the results of his company but if he's not too uncomfortable to keep looking for a solution either.

When your company is not performing well, it affects your personal life too, that´s a reality. You can't separate your personal life from your business life. When you have business problems, you are stressed and you take these problems with you everywhere. You take them home, to the golf course, to the gym, when hanging out with your friends and even when you go on vacation with your family.

So, fixing the problems in your company should be a priority for you because it will also help you to fix the problems in your personal and family life, and therefore will improve your health as a plus.

If you are reading this book is because you are uncomfortable with the results of your business, because you are experiencing some profitability problems in your company you have not been able to fix, so you are looking for new ways to improve your results. Well, I can tell you that most of the time this happens because you haven´t found the real origin of your problems and that is what explains why the actions you have taken to solve them have not worked as expected, because you are pushing the wrong buttons in the first place.

After analyzing a good number of companies, I have found out that there are four basic mistakes made by business owners that negatively impact their performance, and therefore their profits, and which generate them a lot of stress, in some cases even a loss of interest in their companies so they stop looking for a solution.

In this book I explain these four basic mistakes in a rather simple way so it is easy to understand. I wish this book ignites your entrepreneurial spirit again and move you to solve your problems and increase your profits so you can enjoy life again.

(*) Take note that when I mention business owners, I also refer to CEOs or the person who manages the company.

CHAPTER ONE.

MISTAKE 1: MISMANAGEMENT.

"Nobody can go back and start a new beginning,
but anyone can start today and make a new ending."

- Maria Robinson

1. You could be the cause of the under-performance.

Most small business owners manage their own companies. They created them from scratch using their own money and resources, and most of them continue running their companies until today. Being the ones with more time in the company they think they are the best person to do the job.

In many cases, this is true but it is also true that frequently they are knowledgeable in just one or two specific areas like: production, design or selling, but they lack the knowledge in management.

First time business owners don't know how complicated it is to start a business, since they haven´t gone through that experience before so they make many mistakes. They realize that it is much harder than they thought but now it is too late to go back. Everybody makes mistakes when doing something new for the first time, that´s normal, the good news is that the best way to learn is by making mistakes, provided that you commit to fix them and that you learn enough for not to repeat them again!

As your business grows, you need to learn more about management in order to be able to run your company smoothly and profitably. Lack of preparation can lead to business failure. Knowing well about the technical area or sales is not enough to run a company. In fact, it is a very different type of knowledge and skills you need to manage a company.

It is hard for a business owner to accept that he could be the reason of his company´s low profitability. Nobody in his company will dare to tell him that he is preventing the company to get better results. It usually takes a long time for an owner to reach to this conclusion by himself, and sometimes it never happens. This is why it is advisable to look for feedback and to be open and humble to hear and accept negative comments from your trustworthy employees and friends. Acceptance is the first step to make a change.

Acceptance is the first step to make a change.

Don´t wait until someone else tells you about your faults or until you live the cost of your mistakes, it is better that you make a self-analysis, or an evaluation made by knowledgeable persons, to find out if you are causing your business underperformance. Ego can cost you a lot. Chances are you are not the main cause of a low profitability… but you better find out.

Charlie, the owner of the furniture manufacturing company I mentioned before, after many years blaming others for the low profitability of his business now accepts that he is the main reason for the bad results of his company. He has lost the drive necessary to make the changes needed to make his company profitable again so his company continues underperforming. He has talked about selling his company but he is aware of the low price he could get for it in its present condition and the difficult it would be to find buyers interested in a non-profitable business. He is trapped in a dilemma and, in the meantime, things continue the same way.

2. Wrong calculations.

Making wrong calculations is one of the main reasons why a company can fail. There are two ways in which making wrong calculations can make a business fail.

New businesses.

The first one is when starting a new company, because the business owner doesn´t take into account the time it will take for his new business to take off. He usually is too optimist and think that as soon as he opens his new business clients will flow in and revenue will easily and promptly cover operating expenses. But this is wrong, new businesses no one knows of can take 12, 18 or up to 24 months to generate enough revenue to cover expenses. Business owners think that having the money for the initial investment and a little more will be enough but that is just not true.

I see it all the time, employees who are laid off use their savings to open a new business. They are too excited because now they are going to be entrepreneurs and will be their own boss. They cut the ribbon of their shiny new store or office, place several adds and wait for clients to come but they don´t come as soon as expected. In the mean time they have to pay for rent, utilities, salaries and other expenses so they have to put more money into their business. In many cases, they don´t have other source of income so they depend on the income that will generate their new business, but meanwhile they have to pay for family and house expenses like: schools, mortgage, utilities, food and so on.

Many new business owners don´t take into account the learning curve during which they will make mistakes that will have an additional cost for them like: uncollectible sales, defective products, returns, higher inventories…and others.

So, the magic of opening a new business vanishes and it becomes a nightmare instead. They realize that they can´t afford to keep their business open until they decide to close it and lose their savings. My advice is to be conservative when estimating the time it will take to have the revenue they need and have more money in reserves to confront this problem.

Existing businesses.

The other way in why making wrong calculations can make a business fail is when the business owner doesn´t understand the impact the operating cycle duration has in the liquidity and profitability of his business. Let me explain…an operating or business cycle is the time it takes from taking orders from clients to collecting the money from them.

Many business owners make wrong calculations about the necessary money to run their companies so they experience cashflow problems that derive in lower profits and liquidity problems.

Even businesses that have been operating for a long time can have recurrent or even permanent profitability problems because the owner works with a very tight budget.

This is the case of Javier, an owner of a manufacturing company, who has operated his business for more than 20 years now and who has always had profitability and cash flow problems. Why is this? It is because he takes out more money from his company for personal expenses than he should thus creating a liquidity problem by not leaving enough cash for working capital. This is a clear mismanagement problem.

The longer the operating cycle, the higher the amount of working capital needed to run the company without problems…and guess who has to put or get that additional money, well…you guessed right…YOU are the one. You either put your own money (along with your partners if you have them), or you have to get it from banks or other financial institutions.

The longer the operating cycle, the higher the amount of working capital needed.

It is not bad to get external financing, in fact many companies do get it. The wrong thing to do is having an excess of interest-bearing financing that hurts your company´s liquidity and profitability. Making wrong calculations about the operating cycle duration can put you in a difficult lack of liquidity situation that can generate a lot of pressure on your company.

3. The Jack of all trades.

Small business owners make a lot of work themselves when starting their businesses. Usually, they start with few employees, if any, and they have to do many, if not all, the work required to start the company, meaning that they have to use many different hats at the same time.

Owners work in many areas simultaneously when they create a new business. They have to file the company, provide the services or the products they sell, and make administrative tasks, among others. They are the jack of all trades.

It doesn´t matter what field the business owner chooses, he needs to confront problems in areas he doesn't know well. He can hire external services but most activities have to be carried out or supervised by himself. That's the main reason why he makes many mistakes because he doesn´t have all types of skills required for running a company.

As the company grows, available time becomes a scarce resource for the owner, daily problems and activities take most of his time and this affects the mid and long-term performance of the business because he is not devoting enough time to plan for the future. He needs to delegate ordinary tasks to free part of his time so he can concentrate in more important matters. He also needs to decentralize the decision making so he is not a bottle neck in the normal activities of the business.

Many business´ owners don´t recognize this problem and that´s the reason why their companies underperform. They become the main cause of the underperformance which sooner or later take them to either run a non-profitable company for many years or being forced to close it.

As the business grows it is imperative that the owner learns how to manage a company or hire a capable CEO to do the work effectively. But, in any case, he needs to be involved in important decisions, he can´t dissociate from leading the direction of the company and that also requires preparation.

If you are overwhelmed with your daily operations, it means you are not delegating enough and you are not organizing well the use of your time. You need to establish priorities and not to be absorbed by minor issues. If time passes by and your company doesn´t advance it is because you are not solving the right problems.

If you think that because you are working more than 10 hours a day, and on weekends, things are going to improve, you are wrong. It is matter of making smart moves rather than working harder. One smart decision worth's more than 100 hours of hard unintelligent work.

One smart decision worth´s more than 100 hours of hard unintelligent work.

4. Lack of Knowledge.

The main role of a business owner is to guide and lead the business, and make the important decisions (non-important decisions can be delegated to your team). In order to make good decisions he needs to be knowledgeable otherwise the probability of making bad decisions will skyrocket. You need to grow first so you can grow your company profitably.

You need to grow first so you can grow your company profitably.

Mismanagement is one of the main reasons for business failure. This happens when you make more mistakes that the business can support. You have to make sure that both you and your team are knowledgeable in their respective fields. This means you need to learn and be well prepared in those areas where you are not savvy.

Mismanagement is one of the main reasons for business failure.

It doesn´t matter if you hire a CEO to run your company, if you want your business to be profitable you still are going to make the important decisions, you can´t leave the future of your company in the hands of others. If your business fails, it will be your fault and it will cost you big money you but for your CEO, he will simply look for another job.

It is a mistake to think that hiring a CEO to run your business will free you from your responsibilities as the owner of the company.

This is the case of a family who owns a restaurant chain in an important city decided to hire a CEO to solve their profitability problems because some members of the family were too stressed managing the company. So, they did so and devoted their time to other projects without closely supervising the actions taken by the new CEO. A year later they realized that results were worse than before so they fired the CEO and took control of the company again.

You better learn all those things you need to become knowledgeable in management otherwise you will not be able to conduct your business successfully. You will be like a captain of a ship who doesn´t know how to direct the ship nor give orders to his crew. You will arrive to a different destination than the one you intended and will use much more resources.

When your company is small it is even more important that you learn how to manage your business because resources as rather scarce. When your company grows and you have more resources you will be able to hire an experienced team to run your business. But even then, you will still be responsible for the results of your company.

5. Things become too complicated.

As a business grows things become more complicated and the business owner can lose control of his company. Now, his company is a different animal than the one it was when he started it or when it was smaller. More activities, more things to deal with make it very difficult to run the company and the owner can´t be focused on everything at the same time. He needs help, he has to recognize that he needs that help otherwise he will be an obstacle for the development of his company. He has to have a clear mind on where he needs that help and what exactly is what he needs.

First of all, he needs more people to make the tasks, the right people, the one that will help him to run his company profitably. He needs to choose carefully in order to achieve the results he desires. People with experience, who know what they are doing and do it right.

Another thing he needs, is systems, systems that helps him to have a better control of his company, to organize all the work and that provide good information. For example, a good accounting system that provides him with reliable information.

If he is in the manufacturing business, he needs to have a good production programming system too. He also needs to have a good control of his clients, of accounts receivable, accounts payable, and so on and so forth, so he can anticipate the amount of money he is going to receive and the one he will need to pay his suppliers.

If he is not well organized, he will not foresee the problems that could arise until they become real. He needs to be aware that he has to move up to a higher level to see the whole picture otherwise his company will be stuck, it will not grow and problems will start to pop up.

A business owner must not centralize all decision-making otherwise he will obstruct the company´s development. If the company keeps growing, things will become more complicated and the owner will not be able to handle them. He needs to be humble and realistic and accept that he needs to change, changing himself from being an operator to become a manager that will bring a positive change in his company that

that will open the door to a healthy growth of the company.

When the business owner is causing a bottle neck in the company not only leaves out the contribution of other key members of the team but he also slows down the decision-making process and that of the operations which harms the efficiency of the business.

I know business owners who are afraid of being away of their business because things could go wrong in their absence. They prefer to work than go on vacation and usually their vacations are rather short, and when they are away, they are in constant communication with their team making decisions. You better form a competent team that can run your business even in your absence.

You better form a competent team that can run your business even in your absence.

6. It affects your personal life too.

If your company is not performing well, it affects your personal life too, that´s a reality. You can't separate your personal life from your business life. When you have business problems, you're stressed and you take these problems with you everywhere. You take them home, to the golf course, to the gym and when hanging out with your friends.

Because your business life is tied to your personal life, if you don't solve the problems you have in your company, you will not enjoy your life as you should and, most probably, it will affect your personal relationships with your friends and with your family, and you will not be able to sleep well either.

When you have money problems in your company, most probably you will have money problems at home too. You will not be able to buy a new car or go on vacation with your family to the places you would like to go and you will feel frustrated. So, the sooner you realize that you have to deal with and fix your problems at the company, the sooner you will be able to fix your personal life too.

When you understand that you need to change your attitude and acquire other skills to manage your company, then you will be able to improve the results in your business. When you solve your problems in your business, you will feel better, you will feel fulfilled and you will feel more energized. And that's reflected right away in the way you relate with others, even in the way you look…and life becomes more comfortable for you.

Fixing your business problems will also help you to fix your problems in your personal life. Have you noticed that when you have problems in your business, you are in bad mood? And when you get home and your wife or your kids bring you little problems, you make them bigger, you become angry and probably you even shout them for minor things? Well, that´s how it affects your relationship with your family.

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CHAPTER TWO.

MISTAKE 2: LACK OF PLANNING.

"You cannot change your destination overnight,
but you can change your direction overnight."

- Jim Rohn

1. No Target, no Direction.

Planning is bringing the future to the present so you can make decisions now that will take you to reach your goals in the future. It is defining where you want to be in a future time and determine the steps you need to take to get there.

> *Planning is bringing the future to the present so you can make decisions now.*

All roads look the same when you don´t know your destination but you will know you´ve taken the wrong one when you see you are going nowhere.

When you don´t have a plan, you are out of focus and your efforts are rather dispersed. You are not effective and you don´t give direction to your actions. You could be wondering why you are in the same place five years from now. The same problems can continue indefinitely unless you do something different to fix them.

The same problems can continue indefinitely unless you do something different to fix them.

Planning is not only defining your goals but also making a plan of action describing the different steps to take to reach them. In order to define and accomplish your goals it is imperative to discover what is stopping you to reach your profitability goals. If you make your plans but they are not stated in an explicit way, you will not be clear on what problems you and your team have to overcome and it could be a waste of time, effort and resources.

It is not enough to say you want to grow and increase your profits but you need to be specific when defining your goals. It is imperative that you define an amount or a percentage and the time when you want to reach that goal.

Examples of goals are:

- Increase your revenue by 20% by December next year.
- Reduce expenses by 15% in the next 6 months.

- Bring 4 new clients every month.
- Become the third largest local supplier in 5 years.

Besides, you need to break-down your goals into short-term goals (sometimes monthly goals, other times quarterly goals and other times even weekly goals, it depends on the type of goal), and assign responsibilities for reaching them. The more specific you are the clearer the instructions for each member of the team and the fewer misunderstandings.

An important part of planning is identifying what is preventing you to reach your goals so your efforts are aimed in the right direction. Otherwise, your chances of getting the desired results will be rather slim and you could end frustrated.

One of the main reasons why business owners can´t solve their problems is that they don´t know the origin of their problems. They know they are not generating enough profits but they don´t know which buttons to push to fix this situation. Remember that 50% of a solution is to know exactly what is causing your problems and then it will be easier to act to solve them, which is the other 50%.

50% of the solution is to know exactly what is causing your problems.

Only after discovering what is stopping you from reaching your goals you will be able to take action to start moving in the right direction.

2. What to expect from your business.

A business owner should know what to expect from his business in terms of profitability when he decides the industry and the market niche he is going to participate in. Some markets have many competitors and therefore lower margins and others are less competed and offer higher margins. Additionally, some industries require a heavy investment and others require a low investment. Both variables impact directly in your profitability.

Each industry and market niche has its own characteristics and expected profitability levels. Exception to these rules is when there is a Monopoly, an Oligopoly or the company introduces groundbreaking innovations or technology, and when there are too few competitors or none at all. In these cases, profitability could be much higher than the average of the industry.

Expecting a higher profitability from a business than what the industry and market offers is an illusion that may lead to frustration (except for the exceptions mentioned in the previous paragraph). If the business owner doesn´t know well the market average profitability he could think that he is doing a bad job when in fact he is not. But, on the other side, his company could be underperforming and he could not be aware of it. That´s why knowing what to expect is so important.

No matter the industry and market you participate in, there is always a way to improve your performance and increase your profits up to a certain point. For this reason, is important to perform an analysis of where you stand in terms of profitability and look for opportunities to improve it.

No matter the industry you participate in, there is always a way to improve your performance.

In many cases it is obvious that the company is underperforming because a clear low profitability (or even having losses), and cash flow problems. In these situations, it is a must to find the origin of your problems so you can act to fix them and increase your profits.

When you detect that your company is underperforming, right away you should devote your time to find the reason of this situation and make the required changes to improve your results. If time passes by and you don´t take action, your impulse to fix this situation will fade away and things will continue the same.

3. Strategic thinking.

The main job of a business owner is to set the goals for the company, and to coordinate, supervise and lead the advancement toward its accomplishment. He also needs to provide the resources needed to carry out the activities to reach them.

So, he must have a strategic thinking, a long-term view of the company, and divide those long-term goals into shorter periods until defining the budget for the year and assign each member of his team responsibilities.

The clearer your visions about where you want to take your business in the long run, the easier will be for you to define long-term, mid-term and short-term goals. Clarity makes decision making easier.

Clarity makes decision making easier.

Clarity comes from having good information and a good understanding of how things work. Good information is useless if you don´t know how to use it and knowing how things work without having good information is also useless. The combination of the two, good information and a good understanding, is what makes the magic for making good decisions.

Strategic decisions have a bigger impact in your business than operating decisions and require a higher level of clarity, a long-term vision of where you see your business in 5 and 10 years. You, as the owner, have the highest position in your company so it is your duty to prepare yourself to deliver good high-level decisions.

An effective team will create free time for you so you can focus in the future of your company. You will have time for defining strategies and activities to be done to create a better future for your company and for yourself.

A good team not only will save you time and improve your efficiency, but also will implement the changes that you agree with them to improve the performance of the company. During this process is good that you hear your team´s opinion because they can enrich your vision and provide you creative ideas to improve the performance of your company.

The better your team understands and shares your vision, the easier will be to reach your long-term goals because they will know exactly where you want to go and how they can help to get it. Each of them will perform their tasks in a coordinated manner. It is like an orchestra, you will write or choose the score and each of the musicians will play its part, and you will be the director of the orchestra coordinating the performance of each of them.

4. You are the leader.

Do you remember those great battles in the movies at the time of the Roman Empire, with thousands of soldiers on each side? The emperor planned which territory he wanted to conquer and made plans to beat his enemy. He got together with his generals to define a strategy to fight them and gave them specific orders. The generals would organize their legions to prepare for the fight and will continually inform the emperor about the progress of the battle so he can make changes about the actions to take during the battle when necessary. Remember that those battles could last weeks, or months or even years.

Well, something similar happens in a company, the owner or the CEO… I am mean YOU, are the one who must define the goals for your business and get together with your senior team to formulate a strategy to reach them. Then, your team will organize their subordinates to move in the same direction so everybody knows well the goals and their respective tasks. They will also inform you about the progress of your plans and get together to make adjustments when necessary.

The message in this example is that you must lead your company if you want your company to be successful. It is tragic to see companies whose owner or CEO are not leading their companies. There are not clear goals and instructions to their subordinates so the company underperforms and profits are rather sluggish.

There are four attributes of a good leader:

1. Clear vision of what he wants to achieve.
2. Knowledge / Experience on what should be done.
3. Energy to command the organization.
4. Good communicator.

All four attributes are necessary for the success of your business. Without vision, there is no direction, no goals, so efforts will be dispersed. Without, knowledge or experience, you will not be sure if you are doing the right things. Without energy, you will not have the push and determination required to take your company to reach its goals. And without good communication it will be difficult to coordinate the efforts of your employees, effectiveness will diminish making it difficult to reach your goals and win the battle.

Your subordinates easily detect when one or more of these attributes are absent in the owner or the CEO and react in consequence. I am sure you have seen companies where all employees feel part of it and share the enthusiasm, they are proud of being part of a company...you can feel it. On the other side of the coin, there are companies where employees just work for their salaries and don´t feel any appreciation for the company. This translates into high turnover, lower quality and bad service, and lack of energy.

5. Big things are made of little things.

Everything that surround us is made of little things. The Universe is made of constellations and constellations are made of stars and planets and if you keep drilling down you will find that even atoms are made of electric charges.

And all of them are interconnected so changes in one thing affect other things with a major or minor impact. For instance, changes in our sun radiation emissions affect earth´s climate causing changes in the temperature of the sea which in turn creates the conditions to have more or less hurricanes. More hurricanes cause more rainfall in some parts of the world which can cause flooding…etc., etc. Well, I think you get it!

Well, the same happens in a business. Many small things affect the performance of a company for good or bad. Major changes in a company are easy to find and deduct their impact on results but little changes are much more difficult to detect and to foresee their impact. However, these little changes add up and define the performance of your company. By fixing those little things you can fix the underperformance of your business.

> *"If you do the little jobs well, the big ones will take care of themselves."*
>
> - *Dale Carnegie*

Your job is to find those little things that are affecting the results of your company and fix them. And then, and only then, you will take control of your business.

CHAPTER THREE.

MISTAKE 3: CASH FLOW CHAOS.

"More businesses fail because of lack of cash than for lack of profits."

- Jorge Colin

1. Cash, the life-blood of your business.

The most important variable in your business is cash. Since cash is the life-blood of your business, if your company doesn´t have enough cash it surely will die, but not before stumbling several times before dropping dead.

Cash is the life-blood of your business.

You need cash no matter the level of activity of your business. If it has a low level of activity, it needs cash, and if it has a high level of activity, it needs even more cash. Even when your business is not operating you need money to pay the rent, utilities and other fixed expenses. There is a rule that says that the higher your level of activity, the higher will be your cash requirements.

The higher your level of activity, the higher your cash requirements.

When a company doesn´t have enough cash to pay to its suppliers, they don´t deliver the raw material, products and services you need. When the company can´t pay its employees´ salaries the production and activity of the business cease. You can´t deliver your products and services to your clients and you stop receiving their payments. It is a complete chaos and your company suffers a heart attack and dies.

You need to carefully plan your cash inflows and outflows to guarantee that you will always have enough cash for your operations either from internal generation or from external sources like financial institutions or from the shareholders.

Have you ever seen businesses growing and with a good sales level that suddenly close their doors? Well, I have! I see this happening all the time. It happens to all sizes of businesses not just to small businesses. The more frequent reason for this is cashflow problems.

2. Internal cash generation.

Internal cash generation is the cash generated by the normal operations of the business. The higher the internal cash generation of a company, the healthier it is because it means it has a lower dependence on external financing sources. Having lower levels of debt will also lower expenses and cash outflows because interest and principal payments will be lower and this way it will be able to create cash reserves and pay dividends to its shareholders.

The higher the internal cash generation a company has, the healthier it is.

The internal cash generation is the main driver of a business. If there is enough cash generation you will not have problems with your working capital nor to pay dividends, nor for growing. Many of the big problems in a company are generated by the lack of cash.

There are several variables that affect your internal cash generation you should revise and optimize in order to increase your cash availability being the main ones: your margins and your operating cycle duration.

High margins drive not only to higher profits but also to healthier cash flows and an increased internal cash generation. There is more room for covering operating expenses and have cash surplus. If your business has a small gross margin, it will be more difficult to create cash reserves and pay dividends, and you will have a higher dependence of external financing sources to get the cash needed for your operations.

3. Your operating cycle.

Your operating cycle duration is a very important variable because it impacts directly on your cash flows. The longer your operating cycle, the higher the cash needs to maintain your operations. A business that collects payments from clients in 120 days needs much more cash than a business that collects them in 60 days. This variable is ruled generally by the industry you participate in and your position within the industry.

The longer your operating cycle, the higher the cash needs.

An operating business cycle duration comprises from the day you receive an order to the day you collect the money from your sale. As part of the operating cycle there are a number of stages in the middle like: the time it takes to order and receive the materials and products you need to manufacture or get the final products from the suppliers; the time it takes to produce or manufacture your products and services; the time it takes to deliver your products and services, and the time it takes to collect the money from your clients, among other smaller processes.

In order to reduce your operating cycle, you need to revise all the different activities involved and look for ways to reduce the overall time meaning that you need to increase your efficiency. This will translate into less money invested in working capital which is a good thing because your liquidity will improve and your cash requirements will be lower.

When you have big companies as clients, they will usually ask for longer payment times which will negatively impact your operating cycle duration. They will also ask for higher discounts which translates into lower margins. So, you better choose the right mix of clients. Don´t be dazzled by big names that can hurt your business finances if you bring them as clients. I have seen healthy companies to get in trouble when bringing new big clients and I have also seen troubled companies whose finances improve when letting go big clients. It is far better to have a smaller but profitable business than a bigger but unprofitable business.

It is far better to have a smaller but profitable business than a bigger but unprofitable business.

Troubled businesses are headaches for the owner. Your main goal should be to have a profitable and healthy business rather than focusing just in growth. Both small and big size companies can fail if they are not well managed. First, make your company profitable and then grow and not the other way around thinking that becoming bigger will be the answer.

4. When to make use of debt.

A healthy company, with a good internal cash generation, will have lower external financing needs, however, it could be convenient to use debt for the following three reasons:

- For working capital due to accelerated growth.
- For acquiring costly new machinery and equipment.
- For construction or real estate acquisition.

<u>For working capital due to accelerated growth.</u>

When your business grows faster than your internal cash generation you will need additional cash to support that growth otherwise you will stress the liquidity of your company and your normal operations can become a big headache for you. The usual source to get external financing is from commercial banks.

A smart move is to open revolving lines of credit for working capital with a couple of banks so you will have the money you need available for when you need it. Don´t wait until you need the money to approach banks because the internal process with them can take longer than you expect and this could create a problem with the delivery time to your clients.

For acquiring costly new machinery and equipment.

When you need to buy new expensive machinery and equipment it is better to use external financing than to take money used for working capital, unless you have big unused cash reserve. If you take cash from your working capital to finance for the acquisitions you are risking the liquidity of your business.

Since, machinery and equipment last several to many years, it is convenient to use mid-term financing either directly from the seller of these assets or from banks. Besides, these assets will depreciate through several years which help to pay lower taxes.

For construction or real estate acquisition.

When you expand or remodel your facilities, or acquire new ones, you should use long-term financing because this type of asset is a long-term asset that you can depreciate to 10 to 20 years depending on the type of asset.

As a rule of thumb, mid and long-term assets should be financed with mid and long-term loans.

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Tip: A smart move made by some business owners when the company has little financial leverage, is that they leverage the company by taking new loans and use that money to pay them higher dividends or pay part of their capital contributions back. This way they can take money out of the company with a little impact on the business.

5. Cash reserves can save your company.

When you have a healthy internal cash generation you should start creating a cash reserve. Before paying dividends to the shareholders, you should create a cash reserve for unexpected events. The market can be affected by sudden changes in the economy and you will be well prepared for resisting those changes. This cash reserve can also be used to take advantage of business opportunities that could arise.

When you have a healthy internal cash generation you should start creating a cash reserve.

It is no frequent to find companies that have a good cash reserve. Most business owners think that having an unused cash reserve is unproductive. They don´t realize that this is like having an insurance for liquidity. Many think that having lines of credit with banks is enough but, during an economic crisis, banks become very tight and the money from lines of credit could not be available…and you know, economic crisis do happen!

I once met an old and very wise business owner of a very prosperous mid-size company in the injection molding industry. He showed me the balance statement of his company and to my surprise he had several million dollars invested in money market securities. He told me that he had learned throughout the years the advantage of having a cash reserve for the "difficult times". When the economy was bad and banks had tightened their loan policies, he had been able to take business from his competitors who had liquidity problems and could not fulfill the orders from clients. Now, several years later his business has grown three-fold and is a very prosperous business.

CHAPTER FOUR.

MISTAKE 4: FAIL TO FIND THE ORIGIN OF THE PROBLEMS.

“Challenges are what make life interesting; overcoming them is what makes life meaningful.”

- *Joshua J. Marine*

1. Do you receive good information?

Do you receive good information for decision making? Is this information reliable? Do you receive it in a timely manner? Is this information understandable and presented in such a way that it helps you to make good decisions?

Remember that garbage in, garbage out. This means that if you do not receive good information, you could be making wrong decisions that will affect the performance of your company.

There are three characteristics of good information for decision making:

1) It should be reliable, meaning it reflects reality.
2) It is delivered in a timely manner.
3) It is presented in an understandable way.

If the information you receive is not reliable you could be making bad decisions based on wrong information. You could be thinking that the company is performing in a certain way when it is not and take you in the wrong direction. You could be thinking that you're making the right decisions when in fact you're not.

If the information you receive is not reliable you could be making bad decisions.

If it takes too much time to receive your financial information, you could be making delayed decisions that can be costly for you, and problems could be much more difficult to solve. For example, if payments from your clients are taking more time than usual and you don't know it because you receive your financial information too deferred, it could cause you liquidity problems. Another example is, if you have a higher than usual level of refunds and you are not aware of it, then you don´t do anything to fix the problem which translates into lower revenue and therefore lower profits.

Receiving disorganized information can also affect your decision making because it's not presented in such a way that helps you to see what's really going on in your company. This situation will confuse you and the information will not help you to see the real picture of what's going on in your company. You will suffer from mental clogging.

In order to receive timely and reliable information you need to have a good information systems and trustable people managing them, committed to update the information and send you understandable financial reports on time.

This information should be analyzed in order to be useful for decision making. Financial statements by itself are not enough to have a clear vision of the performance of a company, you need to drill down in order to know why is your company having the actual results so you can make decisions to improve them.

2. Don´t trust your accountant.

You may be wondering why you shouldn't trust your accountant. Well, the reason is that many times business owners think his accountant also has the role of your financial advisor and trust him so much that don´t question his advice. But important decisions must be made by the owner of the company who should have a complete understanding of every sensible situation, and not by the accountant because, if something goes wrong, the accountant will not suffer the consequences, he will continue receiving his salary or monthly fees, but you will be hit by the bad performance of your company.

In many cases, a bad performance of your company can lead to a poor liquidity situation which means you will need to put more money into the company…and that is bad news.

It is your responsibility, as the business owner, to lead your company and make it generate profits, it's not your accountant’s role. His role is to provide you with reliable and timely financial information about the performance of your company so you can make good decisions. He should provide you with this information in an organized way so you can see how your business is performing, and be able to detect if something is not going right so you can take corrective actions to fix the underperformance of your company.

Decision making should be based on reliable and timely information provided by the accountant.

Delegating this responsibility of following up the performance of your company to the accountant or even to your financial advisor is not a wise thing to do. Their responsibility is to make things easier for you to make decisions, good decisions. So, you shouldn't trust your accountant if he's telling you what to do, that´s your responsibility, not his.

You have to be sure that the information you receive is reliable and that you receive it a timely manner, so you can make good decisions knowing that the information of the performance of your company is correct.

If financial information is not correct, it is the accountant’s fault. If you don´t receive the information on time, it is the accountant´s fault. But if you make wrong decisions, it is your fault, not your accountant´s.

Have in mind that the role of the accountant and your role are different, don't confuse them. Don't blame your accountant if he doesn´t alert you about a bad performance of your company just because you think he is the one responsible. No, his responsibility is to provide you with good information, so you can detect problems and make decisions in consequence.

3. Who is really contributing to your business?

In order to have clarity about the performance of your business you should dive deeper in your analysis to find out who, what, and how are they really contributing to your results. Find which products are contributing in a positive way and which ones in a negative way, which sales representatives are doing a good job and which ones are not, which clients are growing and which ones are not.

In order to have clarity about the performance of your business you should dive deeper in your analysis.

The important thing here is to know who is pushing your sales in the right direction and which products, clients, or sales representatives are not doing a good job and are dragging you down. In order to do so, you need to have good information and you should be able to track and break down the information you need.

Once you discover what is pushing your business forward and what is dragging it down you can make better decisions and filter or discard those who are not helping you to improve your performance. For example, if you find clients who are growing slowly, then you can go deeper and devote time to understand what's going on with those clients. If it's a problem that you can solve like by offering other products or discounts, or maybe it is a problem with service or quality. Check if your sales representatives are visiting your clients and understand their needs.

Once you discover what is pushing your business forward and what is dragging it down you can make better decisions.

The same thing could happen with your products. Find out which products have a high margin and which ones have a small margin. Take measures to improve your gross margin, find out why those products have a low margin and fix it or discard them from your product portfolio. The important thing here is that once you have this information you can act in consequence and increase your bottom line.

In the case of sales representatives, you could have some sales representatives who are not doing a good job and you need to understand why this happens. Maybe it's lack of training or that you have new sales reps. Other reason could be that that there's lack of motivation that you can fix by offering incentives to get better results. Or, if a sales rep is not working, maybe you have to fire him.

These are examples of things you can fix because they are internal problems that you are able to fix but, before being able to push the right buttons, you need to know which are the buttons you need to push.

4. Think twice before chasing big clients.

You need to be very careful when setting sales growth as a priority because you could be making a big mistake. Sales representatives may focus on bringing new clients without knowing their impact in your company especially when they are big companies. Big clients can mean an important sales increase in a short period of time which translates into good commissions for them but they can also hurt your company´s results.

You need to be very careful when setting sales growth as a priority.

For instance, you will need higher amounts of money for working capital derived from higher inventories and higher accounts receivable. Big clients also usually ask for deep discounts because they are used to when buying from their suppliers. These discounts translate into lower margins which impact the profitability of the business. So, you have to think twice before chasing big clients and be prepared to suffer the consequences.

I have seen business owners who are excited when getting large orders because they were able to bring a big client that will increase their sales by 20% in a short period of time but when they realize that this sharp increase in sales means higher money requirements and will put pressure in their company´s liquidity, their smile fades away because many times, they don't have this money. They need to go to the bank and ask for a loan. Now the company will be more indebted than before and things can become more complicated at a fast pace and, sometimes, they either could not receive the money they need on time or not at all due to an unexpected reason.

It can be shocking when they realize that they are not going to get the money they need for working capital as soon as they expect and it will create a liquidity problem. They stretch their liquidity out in order to service this new client negatively affecting their normal operations. It will not only be a problem with the new big client, but it can impact all the other clients because the money will not be enough for purchasing the raw materials or products for the rest of the clients.

Instead of chasing big clients, it is better that you look for clients who´s size is more in proportion to the size of your company so you don't have these types of problems.

Look for clients who´s size is more in proportion to the size of your company.

Another reason for not bringing big clients is that when you bring big clients you will increase your risk of concentration of sales in just one or two clients. You need to make your calculations correctly before bringing new big clients. It can be dazzling at first but when you see the reality you can regret your decision that can negatively impact the rest of your business.

Several years ago, I met one of the owners of a profitable manufacturing company in the plastic injection molding industry who used to have a client who represented 40% of their sales. His client was a well-known company so they were happy to have it as a client. It paid on time and sent stable orders. But when the client decided to change suppliers and stopped buying from this company it became an unprofitable business from one day to the other. The owners wanted to sell their company but its market value now had plummeted.

I have seen business owners who having a stable and profitable company start to have liquidity, profitability, and operating problems because they bring new big clients after setting up sales growth as a priority.

4. Find the origin of your problems first.

The fact of the matter is that if you don´t find the origin of your problems you could be wasting a lot of time and resources without getting positive results. You are aware of the impact of your company´s problems like: low profits (or even loses) and/or negative net cash flows, but the important thing here is to find what is causing this underperformance so you can fix this situation.

If you don´t find the origin of your problems you could be wasting a lot of time and resources without getting positive results.

Trying to fix your problems without knowing exactly what is causing them is like shooting in the dark, your probabilities of hitting the target are rather negligible.

As you should know, 50% of the solution is finding the origin of the problems and the other 50% is acting to fix them. But, how can you act to solve them if you don´t know which nuts to tighten? So, before becoming frustrated because you don´t find a solution you need to seat calmly, get reliable information and make a good analysis until you find what is causing you so much trouble.

> 50% of the solutions is finding the origin of the problems.

I remember once a washing machines technician was revising my home´s washing machine because it wasn´t working well and for my surprise, he fixed it in 10 minutes. He charged me more than I expected for 10 minutes of his time and I asked him why he charged that amount (it didn´t require replacement parts), and he answered me "I could fix the washing machine so fast because I found the origin of the problem and it didn´t require but only some adjustments. If you had not fixed this problem on time, you would have needed to buy a new one so what I am charging is just a fraction of the price of a new one".

I was shocked when hearing the technician´s because he was right! I didn´t have the knowledge to fix the washing machine problem nor wanted to spend the time trying to fix it and at the end of the day I saved money hiring him because otherwise I would have had to buy a new washing machine.

The message here is that when you know exactly the origin of your problem it is much easier to fix it.

When you know exactly the origin of your problem it is much easier to fix it.

CHAPTER FIVE.

CLARITY IS THE KEY.

“Clarity is not focusing on what you see but it is finding what you don´t see.”

- *Jorge Colin*

1. Clarity for making better decisions.

Clarity is not just looking at your numbers but instead clarity is the result of a deep analysis of the numbers plus the experience of someone who has the sensitivity to find what you are missing.

When looking at the bottom line of your Income Statement you realize if your business is profitable or not but it is not clear why are you having that result and what you could make to improve it. Many business owners think that higher sales will solve all their problems and that profits will increase automatically so they set growth as a priority. They offer incentives to their sales people so they go to the street to find new clients using aggressive strategies.

So, some months later, the company increases their sales by 30% and everybody is happy. The owner of the company is very pleased with his sales team and gladly pay them nice commissions and even special bonuses. A couple of months later, he revises the results of his company and he smiles because the first line of the Income Statement is 32% higher. He continues checking the numbers until he finds the bottom line and gets shocked because the net profit now is 10% below than before the sales increase. His jaw hangs down in disbelieve and bewildered, and angry shouts “What the F… happened?”.

Well, this is an example of the outcome of bad decisions made because of the lack of clarity on the origin of his problems. He not only got worsen its results but even paid bonuses to his sales team! It was not the sales team fault but the business owner fault. He made his decision based on a false premise. He should have found out the origin of the low profits first before deciding to grow aggressively.

2. How to find the origin of your problems.

It doesn´t require much to see the effects of a problem, any problem, no matter what type of problem we are talking about. We all see those effects all the time. When our car doesn´t start, that´s the effect, now we need to find out the cause of the problem. It could be a low battery, or an electric failure, or it doesn´t have gasoline, or a number of other things. Unless you first find what is causing the failure you will not be able to start your car. And, when you don´t know how to fix your car problem you call a specialist, or take it to your dealer, who will give you a diagnostic of the failure first and then he will fix it.

Another example is when your laptop doesn´t work, you turn it on but the only thing you see is a black screen which is the effect of the problem, now you need to find out what is the origin of the problem. You wonder if it could be that the battery is too low, or maybe your computer has a virus, or a chip inside failed, or your charger is not generating charge, or any other reasons. Until you find the cause of the failure you can´t act to fix it. Because you are not an expert, after trying some simple solutions and fail, you decide to call an expert.

A similar thing happens with a business, the most frequent effects that you can appreciate are low profitability (or even losses), and cash flow problems. Because a business is a complicated animal, it is a difficult task to find the origin of the problem or problems that are causing these symptoms. What you need is a specialist to find its origin.

Like in the case of the car that doesn´t start or the computer that doesn´t turn on, the specialist uses a mix of tools and experience to find the cause of the problems in your company so you can act to fix them.

The best way to find the origin of your problems is by analyzing the different components of your business. This comprises: your client portfolio structure, your sales policies, your operating cycle, your margins, your operating cycle, and many other components.

Only this way you will be able to see the whole picture of what is going on in your business and you will be able to find what is not working well. Many times, the business owner thinks his business is operating well when it is not. The better information you have, the better decisions you will make.

The better information you have, the better decisions you will make.

Having more useful information will give you clarity and then it will be easier for you to make right decisions.

3. Speed is a competitive advantage.

"Time is money" says the proverb. Nothing is more exact that in the case of a business. The longer the time it takes you to solve a problem, the more it will cost you. You could be losing revenue or having higher expenses due to inefficiencies that affect your bottom line so, the sooner you fix your problems the better.

The longer the time it takes you to solve a problem, the more it will cost you.

Another reason why speed is important is because speed is a competitive advantage. If you advance in low gear because you have inefficiencies or cash flow problems someone else that moves faster than you will capture a bigger market share and could take your clients.

Speed is also related to your operating cycle. If your business cycle is too long, it will take more time to receive the money from your sales which will be reflected in a higher investment in working capital that usually is funded with loans from banks with a cost in the form of interests. When you speed up your whole process, your liquidity position will improve and you will have a lower dependence of external resources. Account receivables will be lower and you will have a healthier financial position.

4. The Clarity program.

Our Clarity program helps business owners and CEOs find the origin of their business problems so they can fix them. We developed a proprietary tool to find the cause(s) of your problems to give you clarity of where you need to focus your efforts in order to improve the performance of your company.

In a very short period of time, you receive our Clarity Report which is a 20+ pages report showing your company´s performance, our diagnosis and our suggestions to improve your results. You can also hire consulting hours to work with you to solve them.

We cover different aspects of your business including: growth, sales contribution, margin per product, efficiency, break-even point, cash generation, and risk concentration, among other.

We send you our Clarity report in just two weeks after receiving your financial and some operating information so you don´t have to wait for a long time and spend a lot of money to start increasing your profits.

For now, we are providing our services to manufacturing companies only but we will extend our services to other types of businesses in the future.

If you are interested in our Clarity program you can contact us through:

- Visit our webpage at www.MoneyPitfalls.com, or
- Send us an email to jcolin@moneypitfalls.com.

“CLARITY IS THE FIRST STEP TO MAKING GOOD DECISIONS”

- *Jorge Colin*

Do you feel your business is not generating the profits you expected?

Are you stressed most of the time because you have tried to fix your problems without success?

Have you invested your money and sweat to start your business, devoting plenty of time to make it profitable, but you haven't gotten the desired rewards?

I have met intelligent business owners who have managed their company for many years and have grown them to more than $10 million in revenue but who still keep struggling because they generate small profits. Since they don´t know exactly where their problems are, they don´t know which buttons to push to fix them. Do you know of similar cases?

Generating higher profits is not that complicated, the secret is to know which buttons to push, to find which cogs are not working properly and repair them, then… profits will flow naturally.

Don´t make the same mistake many business owners make…thinking that growth will make your problems disappear. That is just not true, growing without first fixing your problems can put you in a more difficult situation.

This book will provide you with clarity on how to find and fix those problems that are affecting your profitability so you can increase your profits.