How to ensure your business financial model is profitable

With consumers curtailing spending, rising costs of materials, demand for increased staff wages and rising interest rates, the pressure on small businesses to remain profitable is becoming more difficult every day.

Leaving things to chance is not an option. Business owners and operators need to have a strong understanding of their current and future cash flow requirements, their business operations and where their business breaks even to ensure there is every chance of profitability.

It is becoming more common that to maintain cash flow, some businesses are now not paying their taxation liabilities, effectively making the Australian Taxation Office (ATO) their cash flow provider.

This strategy is dangerous as the ATO will eventually require payment of all outstanding tax debt, including Goods and Services Tax (GST).

Break-even analysis

The first step in any review of a business's finances is to ascertain their current break-even point. This is essential as time goes on and expenses increase. The business owner needs to be sure that income for goods and services has also increased in order to maintain profitability.

To determine an accurate estimate of the break-even point for the business it may be necessary to break down costs on a yearly, monthly and even an hourly basis. These figures can be assessed using past financials or budgets or obtaining information on other businesses of similar size and industry.

Following is an example of just some of the costs that may need to be considered.

Fixed expenses:

- Salary for owner. This should be sufficient to cover personal living expenses and repayments on personal debts
- Staff salaries and wages
- Compulsory memberships or registration fees
- Business loan repayments such as commercial car loans
- Rent
- Insurances including property and professional indemnity payments
- Accountancy or bookkeeping fees

Variable expenses:

- Marketing and advertising costs
- Electricity
- Phone and internet
- Motor vehicle
- Taxes
- Repairs and maintenance of property or plant and equipment
- Replacement of stock

To make a start, break up your expenses for the last 12 months into fixed and variable expenses.

The income challenge

Once you have an indication of expenses, the next step is to calculate how much income you need to break even.

For retail businesses, work out the sale price of units being sold then calculate the amount of units that need to be sold to achieve break-even.

If the business is not achieving current sales targets, then there are a number of questions you need to ask yourself:

- *Should I increase the sale price of the goods?*
    - Are your prices at the bottom, middle or top of the market?
    - Review your prices against your competitors and add more value
    - Do I need to improve the quality or perception of my product(s)?
- *How can I attract more sales?*
    - Review your advertising and marketing strategies and ROI.
- *Where can I reduce my expenses?*
    - There is usually an area in most businesses where expenses can be cut. Take the time to review and source new quotes. Renegotiate with your product suppliers.
- *Is my product undervalued (put price up) or in demand (put price up)?*
- *Is my product comparable to other products in the market?*

For service providers, the process is to analyse expenses and calculate the income required per hour to reach a break-even point. Next step is to estimate the time to be taken to complete a task and complete the calculation.

- Required income per hour multiplied by hours to complete the task.

After completing your calculations, the numbers should indicate whether you need to make changes or if your business is operating profitably.

What are my finance options?

If you don't understand finances, bookkeeping and accounting, then you should outsource these tasks to professionals who specialise in these areas.

It doesn't mean you need to hire an in-house professional, but you should definitely seek professional advice to make sure everything is running smoothly.

This may include one or more professional services to assist with financial analysis and cash flow projections such as:

- a business adviser
- a finance broker
- an accountant
- a financial adviser

Finance professionals can assist with the analysis of your business inflow and outflow to determine the best possible decisions. They are also likely to have an understanding of the range of finance options available to small and medium sized businesses and other financial assistance available through government grants and subsidies.

One major mistake many small business owners make is ignoring lending solutions available based on a perception that an interest rate on a loan is too high.

When considering finance, the small business owner needs to focus on repayments and how the repayments will be covered through existing or increased sales or pricing.

It is important to understand that loan repayments need not be absorbed by the business. A fresh break-even analysis should identify how these repayments can be covered.