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Advertising - Comply With The Law

There are various laws relating to advertising which can be summarised by saying 'be honest' and if you are promising to do something, you have to do it. The experts believe you should be putting yourself in the shoes of consumers. **Don't** promise what you can't deliver and ensure your advertisement will be clearly understood by the consumer.

Over-promising or not delivering what you promised can cause you problems under the **Fair Trading** Legislation which could involve prosecution by the Commerce Commission in New Zealand. Some of the common breaches of advertising rules include:

- 'Two-pricing' advertising - this is where an item was originally claimed to having been listed for sale at the original price (e.g. \$800) and it has now been reduced to half price (e.g. \$400). If called upon to do so by the commission, you need to be able to prove that not only was the item listed for the original sale price, but that you actually made sales at that original price
- 'Bait' advertising - this is where an advertisement is placed which lists an item for a very attractive price but when the potential customer goes to purchase the item, he is told 'sorry, it is no longer available' and then the sales person tries to sell the potential customer another product. If the potential customer complains to the commission they will investigate and take action against the business if the commission believes there was never any stock available to be sold at that very low price. The commission considers that the advertising was only used as a 'bait' to get the potential customer into the store
- 'Omission in advertising' - another problem that can occur in advertising is if important information is deliberately omitted from the advertisement. This can be an offence as it could be alleged that the business has deliberately misled the consumer



Debtors' Financing (Factoring)

A recent Dunn and Bradstreet report on debtors' days outstanding has indicated that debts are outstanding for an average of 44.6 days.

To help overcome the severe cashflow problem that this delay in payments by debtors causes, many small/medium enterprises are using debtors' financing (factoring). Debtors' financing (factoring) effectively allows the business to borrow against the 'value of their debtors book'. Businesses in sectors with very long payment terms such as manufacturing, clothing, wholesale, mining, professional services and printing are suitable businesses for debtors' financing.

If your business is offering credit to customers and you have amounts owing to you in sundry debtors, subject to your turnover level being in the range required by the debtors' financing companies, debtors' financing may enable you to have access to a significant amount of cash without having to offer security over real estate or other assets. The key is then to use that cash effectively in your business for payments to creditors and to negotiate discount rates with suppliers for earlier payment.

We would be happy to discuss your debtors management system with you and look at the possibility of applying for a debtors' financing facility.



What's It Mean?

Gross profit means... the difference between sales and cost of goods sold. Ideally your gross profit should cover the overhead expenses of the business, and achieve the targeted profit for the business.

Sales	\$77,800
<u>Less</u> Cost of Goods Sold	43,300
<u>Equals</u> Gross Profit	\$34,500

Gross Profit % means...

You work out your gross profit percentage from sales and gross profit.

Gross Profit	<u>34,500</u>	X	<u>100</u>
<u>Divided</u> by Sales	77,800		1
<u>Multiplied</u> by 100/1			
<u>Equals</u> Gross Profit ratio		=	44%

The sales required to achieve gross profit depend on the gross profit percentage being earned by the business. You'll be aware of the gross profit percentage you expect to achieve from your business. You will also need to be aware of the individual gross profit percentages of various products.

Net Asset Value... describes the market value of a business' total assets less its liabilities. Normally determined by adding the value of all tangible assets in a business e.g. plant and equipment, motor vehicles, land, buildings, debtors, cash on hand then subtracting liabilities owed by the business including creditors and loans. The resulting figure is termed the Net Asset Value. Please note the value of Goodwill is generally not included in Net Asset Value.

Surviving Recovery

In a bumpy recovery period, you might need to think about steps for surviving recovery, as well as the steps you took to survive the original crisis.

For instance, people's spending habits change, adapting to their circumstances.

The Main Report for Business points out that in a recovery economy, credit is not so easy to obtain as it was during the boom times. Households will tend to prefer to pay for purchases with money they have rather than money they borrow. They also may be carrying a higher debt acquired as they tried to weather the crisis. Both spending and borrowing habits tend to be conservative. This trend can continue for some time.

If your business is in sales, this has an obvious impact. It may, for instance, change the way you market your products and services.

Strategies For Improving Times

There are signs of business improvement. This will assist smaller businesses all over New Zealand, as long as there are no major problems in overseas markets.

However, growing pains during the recovery period may cause severe problems for some businesses.

For instance, if you are using borrowed money, it might be wise to factor in the impact of rising interest rates on your business.

Cashflow and debtor management - Cashflow management is extremely important. Monitor debtors' payment times and try to get your debtors back to normal trading terms. Are your systems for debtor management as good as they could be? Or have you just been following the same systems you had in place during the boom years?

Monitor investments - Monitor stock by conducting regular stockturn calculations and comparing actual turns achieved to budgeted position and then take action to ensure the anticipated stockturn is achieved. Also monitor investment in work in progress (if you have any).

Plan for the future - Staff are going to be very important in ensuring that businesses have a sound future in the recovering economic climate. Have you recruited the right mix of staff and are you investing in staff training?

Innovation - All businesses need to be innovating and developing new products and services which can be offered to customers. What research and development projects could be undertaken in your business?

Export Opportunities - Have you considered exporting your products and services or licensing your technology or business know-how for overseas markets? It might be a good idea to visit the New Zealand Trade and Enterprise website at www.nzte.govt.nz to familiarise yourself with strategies to implement to commence export of products or services successfully.

If you would like our assistance in planning strategies for your business to take advantage of the improving times, including market research and business plans, business reviews and so on, please do not hesitate to contact us.



Be sure to read each article with the mindset "How this could apply to our business". Thinking of it that way will guarantee that you get value. Also make copies for each team member. To really make sure something positive happens, work with your Inspired business development specialists to talk your team through ideas.



Corporate Governance Applies To All Directors

If you are a company director, you have the same corporate governance responsibilities as a director of a major public company, even though you are running a much smaller business.

Directors are responsible for the appointment of the Chief Executive or General Manager and then monitoring the overall performance of the company. This means that directors' meetings should be held regularly. Directors should receive written reports on all matters to be discussed at the meeting at least 48 hours prior to the meeting so that they can read the material prior to the meeting. Directors should be conscious of declaring any interest that they have in matters being discussed at the board of directors meeting.

There are many items to be considered under corporate governance, and directors' responsibilities, some of which are:

- Ensuring that assets are purchased in the company's name
- Ensuring that any borrowings that the company does are on the best possible terms
- Ensuring that a system of internal control has been implemented throughout the company
- Reviewing budgets and cashflow forecasts
- Reviewing periodic monthly financial reports and key performance indicators, comparing these to the budgets and enquiring into the reasons for any variance
- Ensuring that staff are employed under appropriate agreements and that staff evaluations are conducted on at least an annual basis



- Seeking assurance from company accounting personnel that all debts are being paid in the normal course of business
- Ensuring that management is reviewing any environmental issues that may affect the business
- Encouraging management to implement appropriate risk management strategies for events that may affect the company e.g., weather, cyclones, tsunamis, burglary, armed robberies, death or inability of key personnel to perform their duties

“Sustainable recovery, with rebalancing in demand and the economy's productive base, is mostly a microeconomic matter. This means households, firms, banks and investors making the right decisions about where to allocate land, labour, capital and funding.”

Dr Alan Bollard, Reserve Bank of New Zealand, from an address to the Hawkes Bay Chamber of Commerce



Franchising and Business Plan Preparation

Written by Craig Weston, Inspired Director

(for the Australian Franchise Magazine)

I often get phoned by people who are looking to buy a franchise. They want to know if the business is a good buy or not.

They often mention that their bank want a business plan before they will grant finance for the purchase. The Bank has usually mentioned that accountants are good at preparing business plans.

In my experience, the term Business Plan is used to describe two different things

1. **The full on written Plan** which encapsulates things like Vision, Purpose, Mission, , SWOT Analysis, Goals, Strategies, and a financial forecast.

Or

2. **The Basic Financial Forecast** without all the written detail around Vision, Purpose etc. This is usually a forecast showing on a monthly basis for the next 12 to 24 months the sales, expenses and net profit, the projected bank balances, and the balance sheet (a snapshot of the assets and liabilities). There are usually a lot of numbers shown on each page but they are laid out logically and provide good information.

In a perfect world number 1 is the way to go but usually its number 2 that the banks are after and certainly the costs of number 2 are significantly less than number 1.

Because minimization of costs is a real factor in any business and particularly at the start up I like to suggest a mid way solution for prospective franchisees.

First, any prospective franchisee should be able to answer the following questions:

- why am I buying this Franchise
- what do I want from this Franchise? Earnings/lifestyle
- What's my purpose for buying this business
- how long do I want to be in this type of business?
- Would I maybe want to expand by purchasing other similar franchises someday?
- What could I do when I sold this business?
- What do I want to earn as salary from this business and what return on investment do I want on top of that?
- Could I be over committing myself?
- Is my spouse happy with this commitment
- What time commitment will it mean for me?
- Do I understand that working for wages is different from being self employed?
- Do I really understand this business?

I like to put these kind of questions to prospective franchisees as its helps them to "begin with the end in mind" and also helps clarify some of the important issues before things have gone too far down the track.

Second, the **Basic Financial Forecast** referred to above needs to be prepared. It is a comprehensive document and you will need to choose a chartered accountant experienced in franchising to assist you. Ideally your accountant should be a member of the Franchise Association of New Zealand which means they are rubbing shoulders with others in the industry and understand the key differentiators between Franchise and non Franchise businesses. They will also know what people are paying for like franchise businesses and what valuation range is reasonable for the one you as the prospective buyer are looking at.

To assist in preparing the Forecast you will need to obtain information such as:

- Copies of the previous annual financial statements for the past 2 years (ideally prepared by the vendors chartered accountant & not their own home prepared MYOB accounts)
- Sales on a monthly basis for the past three years (excl of GST)
- Copies of GST returns for the past 3 years
- Business Brokers Report
- Wages details for staff employed
- Copy of the sale and purchase agreement (if there is one yet)
- Copy of any Lawyers report on the Franchise
- Copy of the Franchise Agreement which will spell out the terms of the Franchise and what the charges are for such things as monthly franchise fees (royalties), Marketing Levies, and other charges

My approach as a chartered accountant is usually to review all this information, discuss it with the client and then liaise with the other parties involved including the Broker, the lawyer, the Bank, and the Franchisor. This is to ensure that I know as much as possible about the deal so I can assist my client in preparing a Financial Forecast that will be of real value to them.

The value in preparing such a forecast includes:

- It educates the prospective franchisee about the importance of profit and cash flow relationship between the two
- It shows the cash flow effect of how Inventory (stock) purchases and giving credit to customers fits into things
- It highlights the effect of the Gross Profit margin % on the profit result and projected bank balances
- It allows the Bank to see that the business model stacks up and therefore assists in raising finance
- It allows for the Franchisor to see that your business model works and that you will therefore be a successful franchisee
- It allows for sensitivity analysis - this means that certain things like sales, gross profit margin, and wages adjustments can be changed to see what the outcome might be on projected profit and bank balances
- It shows what the breakeven sales need to be (very important)
- Once you have purchased the business It gives you something to track your actual results against
- It shows you how much tax you have to pay and when

It is important to note that forecasting the numbers is not an exact science - no one can precisely predict the future. However there is a good likelihood that you can get a very good idea of your businesses future by preparing this kind of business plan.

So what about the **full on written plan** referred to at the start of this article?

I believe that if not done prior to entering the business, the best time to do this is about one year later. At this time you will know a lot more about the business. Based on this knowledge you will be able to more confidently plan ahead.

What are the important elements of the **full on written plan**?

A Purpose - you should be able to state what the purpose of your business is. Your statement will be the same as the Purpose of the overall Franchise but you may want to tweak that to make it your own. It should clearly answer the question - why are you in business? Interestingly the most common answer to this is "to make money".

I believe that this common answer is really more an outcome of the purpose than the actual purpose. As an example, the purpose of the firm that I work for is "to make a positive and ongoing difference in the lives of our clients, our team and the world around us". In my view "making money" flows from achieving the purpose.



People talk about Vision and Mission as well. I think the word Purpose sums these both up.

SWOT - this stands for Strengths, Weaknesses, Opportunities, and Threats. Every Franchise has these. There will be some things that you are good at and some that you are not. Recognising these factors is the first step, then working out how they can be used to advantage is the next.

Goals - based on your purpose and your SWOT Analysis you should then be able to set some Goals for your business over the next 12 to 24 months (longer if you want). You need to be specific and succinct with each of your goals. They need to be able to be measured and have a date by which you project you will achieve them. When I look back at some of the goals that our clients have set in the past, I am often amazed at the clarity this gave the business owner to go out and succeed.

Strategies - these are the ideas you employ to achieve your goals. They define the actions you will take to meet your goals.

Financial Forecast - you will already have this from the previous year, so it's just a matter updating the previous forecast, but based on the goals you have set going forward. The Forecast therefore becomes what I call "a quantification of your goals".

Summary

The Planning process can be an exciting one and is one that should be done at least annually. As I write this I am assisting a young couple with forward planning for their business - a franchise. As we work through them elements of the plan with them and the financial implications, it is wonderful to see them come up with ideas that will make a real difference in their business and for them personally. I doubt that would have happened if not for this process.

This leads me to my final comment. Franchisees and business people generally are very busy people. It seems there is never enough time in the day to get everything done. So it's therefore matter of priorities. You need to define what things are important and do those. Planning is really important. But you often can't do planning alone - you may need (and I recommend) you use an independent person to assist you with your planning - someone to probe and ask the right questions. The old saying "iron sharpens iron" is true. Your accountant should be up to the task of assisting you with this.

So go for it - and make your dream a reality!



Inspired specialises in financial and accounting advice to the Franchise industry. If you would like to know more about Franchising, please contact Craig on the details below.

E mail craig.weston@inspired.co.nz

Web www.inspired.co.nz

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