

GREG SHERIDAN

BUSINESS SURVIVAL IN THE COVID-19 ERA

*SOUTH AUSTRALIAN BUSINESS
PLANNING CASE STUDIES*



About the author

Greg Sheridan is a Fellow of the Institute of Public Accountants, a Fellow of the Institute of Corporate Governance, and Director of Sheridans Accountants & Financial Planners. He has been in public practice for more than 30 years and dealt with most problems facing small to medium size enterprises. He guides and protects client interests, helping business owners navigate their way through the maze of issues and challenges, including the very substantial challenges currently being posed by COVID-19.

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Introduction

I've been in business for more than 30 years, and I've never experienced a period of turmoil that compares to the business environment brought on by COVID-19.

At the same time, there's a tremendous opportunity for small business owners to re-model to be profitable after COVID-19.

While I provide financial advice to our clients – business owners in South Australia – my own financial services firm has also had to adapt to survive. In this paper, I share client stories as well as our own, as a useful model to how you may approach your business finances.

This paper shares the methodology I used to turn around two businesses in the past 12 months, with lessons still valid for this current environment. I then share an example of how I worked with a client to survive COVID-19, and the changes enacted in my own business.

Greg Sheridan, April 2020

A good business:

1. Pays the owner a commercial wage
2. Pays all taxes as it goes
3. Reduces debt
4. Puts away two months fixed costs

A business with a 10% net profit after owners' wages is a good business.

This is my definition of a good business and is basically the crux of my business advisory work. It is very simple, but most of our clients are true small businesses. Ten per cent profit may seem small to non-business owners but after taking into account an owners' wages it's a very good result. Anything above that is excellent.

Small businesspeople are wonderful people, they work hard and are good fun to know. Although they know their businesses better than anybody, they need help from time to time. This is one such time.

A good business needs to set a commercial salary for the owner. I occasionally look up current wages for a plumber, admin person etc, sometimes using the Hayes Personnel website and sometimes taking an educated guess. I may pick \$70k or \$80k, or with a true manager say \$100k or \$120k. This can be in the form of wages, drawings or dividends but I show this as a cost to the business so you calculate true profit.

A good business should pay its taxes monthly or weekly, or at least put it into a separate bank account. You can survive any crisis without debt, so a good business should aim to have no debt.

This COVID-19 crisis is also about debt levels.

We have advised many of our clients to put away about two months of fixed costs into a separate bank account to sleep well at night and have cash for times such as these. It's very hard to do and you must be profitable to be able to do it but you can start small and just keep adding. It gives you two months to sort things out when there's a crisis. Those that did it are in a good position. There is too much debt and COVID has just brought it to the fore. Businesses (and individuals) with too much debt will fold. Governments will bail out economically important businesses but not others.

Opportunity

There is a real opportunity for business owners to grow their businesses to be more profitable, but it means they probably have to shrink first.

I'm going to share my methodology about two clients who were in dire trouble, pre-COVID – which will show you a useful approach that still applies now. Then I'll follow up with a recent example. All are real clients and actual figures, and their wages figure includes an owner's wage.

Example one: machinery wholesaler

The first example is an experienced, astute business owner who would be good at running any type of business. However through rising costs and during fairly stagnant growth, he found himself making losses.

Machinery Wholesaler ('000)

	Was	Re-model	Change Needed	Tough Decisions
Sales	2160	2160	0	1 staff retrenched 80
Cost of sales	1253	1253	0	Owners wage 30
GP	907	907	0	Hours reduction 33
Wages	660	477	-183	Advertising 48
Fixed Costs	340	280	- 60	Business Coach 12
Net Profit	-93	150	+243	Total savings \$ 203
	Loss	Profitable		Not quite but Survived

Labour Productivity \$1.90 GP for each \$1 of labour

The business owner was turning over \$2.1 m, and after wages of \$660k and fixed costs of \$340k made a loss of \$93k – and it was going to happen again. His turnover was fairly consistent so we assumed it would remain the same, but he could maintain his margins so Gross Profit was the same percentage.

We went through fixed costs and thought we could reduce them by \$60k. We aimed for a net profit of \$150k. Not 10% but good enough for us. Once he agreed with these figures there was only one variable – wages. Wages had to be \$477k or he wouldn't achieve his profit.

Laying someone off is the hardest thing small business owners have to do, but when keeping the business alive – or even keeping your house depends on it – it must be done.

One salesman who was a very good employee left; the owner took a pay cut for 6 months; and other staff reduced hours. We culled redundant advertising spend and a business coach expense.

Total savings were less than we aimed for, but the client was profitable again. Since we did this six months ago he has achieved more profit than we forecast. His sales are actually growing through better marketing.

From our business re-model, if I divide GP of \$907k by wages of \$477k I get \$1.90. I now have an important KPI to help manage his business – for every dollar of wages he needs to make \$1.90 of gross profit. In business the amount of tax you pay is the number one KPI (the more the better).

Example two: builder

The second example is a builder who made a loss for the second year in a row. He had a good reputation but was under too much pressure to make the sales level he needed. A number of his

competitors were falling over. The builder was turning over \$4.7m and made a loss of \$105k. This was two losses in a row and suppliers were anxious. It was a scary time for him.

I met with the builder, his wife and his parents who had a stake in the business, too. He was comfortable – with one less salesman – to sell just over \$250k per month of building jobs. Several permanent labourers would be retrenched so his GP would suffer a bit as the subbies would be charging more. We thought it would be 2% less.

We modelled retrenching 10 workers out of 16 and aimed to reduce fixed costs from \$564k to \$356k. We agreed on a profit target of \$270k so the only variable left was wages, which had to be \$340k. Four of the employees had cars so we could reduce motor vehicle costs a fair bit.

Builder ('000)

	Was	Re-model	Change Targeted	Tough Decisions	
Sales	4754	3120	1634	10 retrenched	680
Mats & Subbies	3206	2153	1054	Fixed costs	165
GP 33%	1547	31% 967	580	+ Sold cars and Equip	
Wages	1088	340	-748	for cash	
Fixed Costs	564	356	- 208		
Net Profit	-105	270		Total savings	\$ 845
	Loss	Profitable		Not quite but Survived	

Labour Productivity \$2.84 GP for each \$1 of labour

I admire him for what he did – and he did it within one week of our meeting. The bonus was getting some cash in by selling vehicles and equipment he would no longer need.

We didn't achieve quite what we wanted but the building company survived when others didn't.

I can report he has made a profit every month for the last 9 months since we met.

He shrunk his business to grow it again. The downside is he is working 12-hour days but is sleeping well, creditors are back on track and he is profitable. When he can, he will employ again but keep track of his new KPI - \$1 of labour must produce \$2.84 of GP for him to remain profitable.

Example three: manufacturing business, COVID-19 era

Now we come to a COVID-19 case. This devastating economic shutdown is going to affect business owners for the rest of their lives but if they have an opportunity to remodel their businesses, they may come out stronger.

This manufacturer had been in operation for many years and turnover had been falling each year as the world went digital, however he still had plenty of work for himself and five employees. Profitability was falling because of lower turnover and he was reluctant to let go of any employees (whom he had known for many years). Some were related.

Within a week in March, he knew his turnover would reduce to about \$30k per month. GP percentage would remain the same and we found \$33k savings in fixed costs, but the most we could get wages down to was \$240k – with one person going and reduced hours for others. \$240k was the bare minimum needed to keep the equipment running.

Manufacturer ('000)

	Pre-COVID	Post-COVID	Post JobKeeper	After
Sales	887	360	360	650
Cost of sales	178	72	72	130
GP	709	288	288	520
Wages	463	240	45	290
Fixed Costs	193	160	160	168
Net Profit	53	- 112	83	62
		+ BAS credit	+BAS credit	
	Profitable	Pull the plug	Survival	Profitable

Labour Productivity \$1.79 GP for each \$1 of labour

This still produced a loss of \$112k so in this case I thought the business would have to fold. I've ignored the BAS credit he will get in April and July. Although good, it's only temporary and covers bills that he was behind in. This would be financially devastating for his family.

Then along came the Federal Government's JobKeeper announcement.

We remodelled again including the wage subsidy. I know JobKeeper is probably only for 6 months, but I like to look at 12-month figures to see what the business looks like. After JobKeeper, the manufacturer's wages bill is \$45k so he actually ends up more profitable than what he was BUT THIS IS ONLY TEMPORARY.

He hopes after COVID-19 that his business will pick up to somewhere between \$360k and \$887k, so we remodelled based on revenue of \$650k including increasing hours of current employees but making sure \$1 of wages produces \$1.79 of GP. He is already working on ways to make everyone's jobs more productive.

It's important to build up those cash reserves – you are going to need them over the next two years. If there is excess cash in your business after the stimulus packages, DO NOT take it out of the business. It is there for the business to survive.

My own business

Several people have said we must be busy and “it’s boom times for accountants”.

It is certainly busy but a lot of it is non-chargeable – we’re helping desperate people. However, we must remain profitable to survive. We know we’ll have clients that will not come back from this.

In our accounting firm we held a quick stand-up meeting in our foyer and asked: “Who is ok to drop a day per fortnight or week if need be?” We had four volunteers, and the landlord reduced our rent by 30%.

My partners and I agreed to drop our wages so overall we could save \$35k per quarter if need be (\$140k for a full year).

Accountant

Savings in Quarter

• 4 staff reduced days either 9 day fn or 4 days	\$ 11600
• Rent reduction	8800
• Owners wages	11400
• Other fixed costs	<u>3300</u>
	Savings for quarter \$ 35100

Write off bad debts

Clean up WIP

Labour Productivity \$1.60 GP for each \$1 of labour

Keep An Eye On ...

The following is a list of items to carefully monitor:

- **Cash reserves – aim for at least two months’ Fixed Costs sitting in a separate bank account**
- Labour productivity – in my firm, I have to get \$1.60 of revenue (gross profit for non-services businesses) for every dollar of labour to achieve a 10% net profit. That’s all wages, including admin and owners.
- Net profit target 10% - **you only** employ more people when your net profit is above 10%.

Keep an eye on labour productivity as I’ve described in the examples and aim for 10% net profit before tax and after owners’ wages. It’s difficult to achieve but it’s a target. These are the main KPIs and every industry has others, but the list above fits most industries.

Final Tips

The next 12 to 24 months are going to be very tough and we need to keep positive.

The following tips summarise how I've managed a business over the past 35 years in practice, and I hope it helps you:

- Don't make decisions without consulting the people that do the actual work. Doing otherwise is *bureaucracy*, and destroys culture.
- Don't ask someone to do something you wouldn't do yourself. I work as a peer, not a boss.
- Assume everyone has good intentions unless they prove otherwise. Sometimes your colleagues are coming from a different perspective, but want the same result.
- Focus on peoples' strengths. Everyone is good at something!

See <https://www.sheridans.net.au/> for more advice and for the company profile.

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