Nine Financial Mistakes That Can Kill Your Business

Some companies fail because they have the wrong product for their target market. Others fail because they have the wrong people running the company. But even with reasonably good products and a competent management team, there are a number of financial mistakes that can kill a company. Over the course of more than 20 years, I've seen tremendous successes and utter failures… and everything in between. The failures due to financial mistakes usually fit into the following nine categories of mistakes.

Mistake 1: Forgetting that cash in versus cash out is THE most important financial measure. Most companies put emphasis on profitability. The dot-com bust is a painful reminder that profitability does matter – but "cash is king". I'll even go one step further – managing cash flow is **THE** most important financial measure in any growing (or stagnating) business. Knowing how much cash is coming in versus the amount required to go out, not only helps you understand what amount can be re-invested in the business but in many cases determines whether a company will survive.

Not all cash coming in must come from operations. Investments, both debt and equity, can provide intermediate cash to run the business. It is critical, though, to know well in advance what your cash needs will be to find the best source of funds.

Any experienced investor will require a clear indication of what the investment will be used for and whether it will be enough to take the company to positive operating cash flow or at least to a stage where additional funding will be available.

If your company requires large investments in equipment or inventory to grow, it is possible that **success can kill your company**. This hypothetical situation draws from what happened at many technology companies: A high technology equipment manufacturer's product generates substantial demand when it is first released. Customer orders far exceed available supply. The manufacturer orders a substantial supply of raw materials and components to meet both unfulfilled orders and a new higher forecast of new orders.

The raw materials and components are added to inventory. However, due to the amount of production time, and possibly competition, customers begin canceling existing orders. The company gets a reputation for not being able to deliver customer orders. New customer orders begin to drop off. The company is now holding an inventory of raw materials and components but has not orders to consume them.

Suppliers must be paid or they won't ship components for any other products. The supplier won't take the inventory back without a large restocking fee or perhaps not at all because the item or material is unique to that customer or is obsolete.

These situations have resulted in millions of dollars of inventory write-offs for what were otherwise successful product launches. Having financial resources available, the ability to identify a variety of potential scenarios, and strong relationships with key vendors can get you through these types of situations. The ability to forecast cash flow and control the key levers that influence cash flow has a lot to do with whether the needed financial resources will be available.

Mistake 2: Not paying your payroll taxes. When companies run into cash flow problems they often start prioritizing what payments they make. And it's easy to think that paying the IRS is less important than paying an important vendor. Often payroll taxes are a substantial amount of money. If you get behind it becomes increasingly difficult to get caught up. And the IRS is very aggressive about making sure that you don't treat tax payments as discretionary.

During the late 1990s, a firm was doing what was described as a "roll-up" – buying smaller companies to create one larger, stronger company that could potentially do a substantial Initial Public Offering. The acquiring company, along with the purchased company, ran into trouble and was struggling to survive during the 2000/2001 stock market decline and related sour economy. The company stopped paying payroll taxes along with not paying vendors.

Not only did the company go out of business, but the Chief Operating Officer (COO) of the parent company was personally sued by the IRS for payment. The IRS often will "break the corporate shield" and seek payment from the individuals that made the decision not to pay the taxes. The COO's personal finances were decimated. Several years later he was still trying to negotiate a settlement for several hundred thousand dollars owed to the IRS. All this, because a company his firm acquired, which he had never set foot in, did not pay payroll taxes and the IRS determined him to be one of the people responsible for making the decision not to pay.

In one of my past roles, I was part of a company that acquired a small, struggling company. IRS rules required that the small company increase the frequency of payroll tax deposits. The company did not make the change right away. The IRS levied a fine that was about 15% of the amount due (i.e. about $8,000 for being a couple weeks late). After a substantial number of conversations and a full day of training (or was it punishment), the IRS rescinded the fine. We were very fortunate.

Through these examples and countless others, the IRS has proven that they don't have a sense of humor and can make your life hell.

Mistake 3: Pricing. Pricing is critical to the success of any business. In fact, many books and articles have been written solely on the subject of pricing. If you sell a product for too little, your company may not be able to cover all its costs or you might be leaving potential profits "on the table". If the price is too high, there may not be any sales. Also, the price of your product communicates information to current and potential customers. Customers often infer the quality and value of a product based on price.

Commodities are products or services that can easily be purchased from many sources. If your product or service is a commodity, then you will have very little ability to price above the competition without adding substantial value in other ways such as additional services, expertise, or "one stop shopping". In cases where your product or services are unique or highly differentiated, there is the potential to premium price. Of course, the unique value must be communicated to, and appreciated by, the customer.

One fairly new company that provided training classes had created and published a new course list. After they began registering students, the company figured out that if every training class was filled completely that they

would still lose money. A little bit of financial modeling ahead of time would have been a big help.

Pricing is more than just setting an asking price (list price, retail price, MSRP etc.) for the product or service. Pricing also includes discounting practices and the "effective" price. Understanding your customers' views and culture are critical to setting the asking price. For example, while on an extended assignment in Singapore, I often dealt with street vendors. The cultural norm is that substantial negotiation is part of every transaction. In nearly every case the item was ultimately purchased for at least 1/3 less than the asking price and often less than 50% of the original price. If your customers expect to negotiate and you set a price that doesn't allow you to give substantial discounts, you will not be successful. The Electronic Design Automation software industry is another industry where customers have learned to expect substantial discounts. You have to get inside the heads of your potential customers and understand how they expect to do business. Of course, this applies to many non-pricing issues as well.

You also have to be careful of what I call the "effective price". In many businesses, incentives are given to encourage the customer to buy. Credit card companies offer frequent flyer miles. Retailers give free shipping and even some vendors offer to customize products. Make sure these incentives are well understood and are based on conscious choices about what is good for the company. Incentives should *NEVER* be offered at the *sole discretion* of a salesperson focused on a current commission. More than one company has failed due to these types of problems.

Mistake 4: Making major expense commitments before revenues materialize or funding is secured. One company president was certain that they would be finalizing a contract to take over another company's customer service organization. Needing facilities for the team, the company executed a lease for office space costing $30,000 per month. The contract for the service organization was never finalized. The company that signed the lease is out of business.

Most entrepreneurs have an almost irrational belief that they can overcome all odds to be successful. While this is close to a requirement for success, don't let your confidence overwhelm your rational thought process. Make sure you know when the decision you are making can kill the company if things don't go your way. Many companies believe customers will beat a path to their door as soon as their product or service becomes available. While you must have a plan to deliver if this does happen, keep financial commitments that require instant customer acceptance for you to pay for them (and stay in business) to a minimum.

Mistake 5: Having the wrong person "handle the books". A president of a company realized he didn't have the information he needed to run the business. The company's controller had been with the company for many years and was loved by everyone. She had evolved into the position without much coaching or financial education.

The combination of the Controller's minimal formal financial training and the President's tendency to be "hands off" on financial details proved disastrous. A closer review showed that not only was the president not getting the information he needed, but the controller had been embezzling money. For this and other

reasons (see Mistake 4) the company is no longer in business.

Make sure you always have more than one person with an intimate understanding of your company's financials. Make a clear, conscious choice about who can sign checks and approve company resource commitments. Fraud is not nearly as common as you would think, based on reading the press. What is very common is that companies get little or no useful financial information to run their companies. Some companies struggle to get accurate, basic historical financial statements within a couple weeks after the end of a month or quarter.

But actual financial statements only show you what has already occurred. Companies really need early warning signals allowing the company to take corrective actions before it's too late. Information such as rolling profit and loss forecasts, order forecasts, cash flow projections, and resource utilization forecasts can tell you when you're headed for trouble. If you haven't modeled the financials, then you could do exactly what your company is trying to do and the company could still fail.

The people handling the financials see information that no one else will see or be aware of unless the financial folks understand and communicate the importance of it. So, they also need to be highly effective at communicating with the people within the company that can, and will, take needed actions.

Mistake 6: Taking money from investors or adding partners that have inconsistent objectives. The other day I heard a venture capitalist (VC) say that the average VC investment lasts longer than the average marriage… and you can't divorce your investors. Every investor has certain expectations. Some expect cash return on their investment within a few years. Some expect to be involved in the management of the business. Some will require control. The list of ways a relationship with an investor can go bad is too long to list here. But as a business owner, you need to make sure you know what your prospective investors' objectives and criteria for success are, before you take their money.

During difficult times I've heard business owners say they would basically take money from anyone who was willing to give it to them. Unfortunately, all money comes with significant strings attached. Whether it comes from your mother-in-law, your bank, a venture capital fund… every one of them has a reason for making that investment and what they expect in return can come back to haunt you for years and years.

Quite often growing companies require funds from multiple sources. The type of investors or company ownership structure can make it impossible for other types of investors to participate. You could end up with investors whom are relatives that "grill" you regularly about when will they get their money back. So, give it some serious thought before you sign the paperwork and cash the check.

Mistake 7: Taking too much money out of the business. You could actually look at this section a continuation of Mistake 1. Most business owners and founders intend to enjoy the fruits of their labor at some point, which is perfectly reasonable. The problem comes when the business owners have not studied the cash needs of the business in enough depth before taking cash out. The cash balances may be fine for a "business as usual"

scenario but not enough to cover a sudden drop off of customer orders.

In some industries you must "grow or die". Your industry could consolidate and require the critical mass of a larger player. Will there be significant costs of upgrading older equipment or increasing the size of your facilities? Make sure you consider a variety of scenarios and understand the financial resources needed to reach your company's objectives… before taking significant amounts of money out of the business.

Mistake 8: Not taking appropriate risks. Taking calculated risks is central to every business success. One sure way to lose in business is to not place any bets. On the other hand, reckless decision making will have about the same odds of succeeding as the odds of consistently winning in Vegas (or worse).

Risk aversion often shows up as an inability to make decisions or the unwillingness to spend even small amounts of money. Business owners and managers sometimes spend far too much time trying to save insignificant amounts of money. I've seen small businesses spend hours upgrading old PCs instead of buying new ones. More often than not, that time would have been far better spent focused on finding paying customers and delivering products and services.

Hiring employees, investing in research and development, spending on marketing programs are all risks. Whether they are calculated risks or recklessness depends on how these decisions are made. No one is correct on 100% of their decisions — unless they don't make any. Keep an eye on your "batting percentage". Some decisions can make or break your company and will require substantial analysis and a higher degree of caution. Other decisions are routine and a perfect solution is not required.

Both severe risk aversion and recklessness are likely to be fatal. Consider the financial and non-financial implications of your decisions carefully.

Mistake 9: Not investing enough in Marketing and Sales. One of the risks a company must take is investing in marketing and sales. Of course, if you are deep into developing your product and do not yet have anything available to market it may be too early to invest substantial amounts into marketing and sales. But if you are a "going concern" you must invest the appropriate amount of time, energy and dollars into identifying and communicating with potential customers, and ultimately converting them into paying customers. This process is one of the most important, if not the most important, process in any company.

Unfortunately, there are endless ways to waste money on marketing. It is not always clear which marketing efforts generate leads or results. Investments in selling activities are not any easier to figure out and sales folks can be high maintenance, temperamental folks (especially when they're not selling much). Companies with an effective marketing and sales process often win out over companies with superior products and technology.

Many of these companies go on to dominate their market. The financial success allows them to out invest their rivals. This closes the product gap. Sometimes they even surpass the quality of their competitors' products. Microsoft and Apple's battle for operating system dominance in the 1980s and early 1990s is the most noted example, but there are many others. So whatever industry

or style of company, you must perfect, refine, and improve whatever process you use to acquire customers. This can be improving a web site for better conversion rates, developing a highly specialized technical sales force or a small company CEO building and strengthening relationships with key customers. Cost reduction can only go so far to improve a company's results. Whatever the financial condition of your company, your process for acquiring customers must be strong or your company will not be.

Many companies have learned these lessons the hard way and some have not survived to tell the stories. Use your instincts, study your financial situation and get guidance from your trusted advisors.

Larry Willeman founded Willeman Strategy Partners, Inc in 2002 to help small and growing companies achieve their business objectives. With experience gained during more than 20 years working for and with both small companies, and large publicly held companies, Larry has helped numerous companies refine business strategies, improve decision making, secure funding and increase the effectiveness of financial operations.

Our mission is to help you build a highly successful company