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Stop the bleeding, then plan for future

Vincent Marino

ONE of my very first restructuring assignments was for a friend who owned three music stores, specialising in the sale of collectable progressive rock music, 70s, 80s and contemporary music. He had opened his first music store in 1996, his second on the coast in 2000 and his third in Rivonia in late 2002.

The stores were manager operated, who were friends.

In the early years, the first store had an average turnover of R35000 a month and operating expenses were R10000. His cost of sales was 40% and gross profit was 60%.

When he opened his second store, monthly turnover peaked at R45000. When he opened his third store turnover had dropped from R35000 to R25000, cost of sales was about 29% but operating expenses had increased by 30%.

When I was called in things looked depressing. Sales were dropping and expenses were increasing.

The first thing I did was analyse the internal situation of the business. Some of the problems I encountered in the first store were:

☐Poor management. He often did not have the relevant information regarding business performance and consequently did not know when a situation required corrective action, often relying on information contained in a diary, where all information was recorded;

☐Inadequate financial controls. A lack of financial controls was leading to a situation where the owner was running out of cash and was unable to pay his accounts;

☐High costs. Businesses that have a higher cost structure than their major competitors are likely to be at a competitive disadvantage; however the more widespread difficulty confronted in turnaround situations is the inability or failure to compete on price;

☐Poor working capital management. Little administration was involved in the management of the business' working capital, with little or no supervision of debtors, stock and cash balance. This resulted in the business being short of working capital and unable to fund growth. Working capital was being used to fund debtors and stock;

☐Lack of marketing efforts. He was failing to keep pace with changes within the marketplace, or to respond adequately to marketplace changes (for example, the opening of other, similar stores);

☐Change in external market demand. The owner was not responding to changes in demand for products or waiting too long to do so; and

☐Competition. There was little clear understanding of the competitors' strengths, limitations, pressures, costs, profitability, market and corporate strategies.

Our first concern was how to survive the short term: to generate cash and generate it quickly. A survival plan was required where funds could be generated internally for quick cash generation.

The key to short-term survival is never to pay out more than you have. We asked the following:

☐Can stock be sold out or returned to suppliers?

☐Can payments to creditors be extended with the correct arrangements?

☐Will it be viable to offer volume discounts to increase sales? and

☐Can a special promotion/sale be implemented immediately?

It was decided that a special promotion would be the quickest and easiest way to generate short-term cash. Stock that had not moved for more than 16 months would be sold off. He e-mailed his entire database to tell them of the special and also sent bulk SMSs to customers.

To our surprise, this special promotion generated R20000 from stock that had not moved; we had budgeted for R10000.

While the sale had given the business a lifeline, we needed to find more cash. The next thing we did was to phone other second-hand CD shops and sell most of the business' non-moving stock that had been standing on the shelves for about three years. This generated about R45000 and helped to pay rent and salaries for about six months.

Once the business had been stabilised we set about implementing financial and management controls, including stricter control of the purchasing of stock, daily sales were recorded and a part-time bookkeeper was employed.

A long-term strategy that was decided on was the sales of stores. A 50% share of the coastal store was sold to the manager and the Rivonia store was sold outright to the manager. This was done because the owner wanted to pursue other interests and he felt the less money he had tied up in the stores the better.

A significant step that is required in solving a business' ailing fortunes is the attitude of the owner. Having a positive attitude and transmitting this attitude throughout the business can have a significantly positive effect on the business.

In times of trouble, owners need to develop a positive mental attitude, forgetting about past failures and concentrating on succeeding. If owners are constantly negative about themselves, their business, their product and staff, no amount of hard work will improve things.

As the owner said to me: "I needed to face up to the reality that my business was in trouble. I had to confront that reality because if I did not, no amount of influence by you or anybody else would have convinced me otherwise."

☐Marino is director, Business Renewal & Survival Strategies (vincemarino@absamail.co.za).