MICHIGAN CFO ASSOCIATES

The #1 Financial Mistake Made by Small-Business Owners

Introduction

Working with dozens of small businesses over the years, we've seen lots of different industries, practices, hurdles, problems and mistakes. But it became clear fairly quickly that the most common – and most severe – of these financial "mistakes" wasn't always obvious to the business owner. . . but was certainly obvious to an outsider.

The #1 Financial Mistake

In short, the #1 Financial Mistakes is this: Relying on the Wrong People.

Study after study shows that financial related problems are frequently responsible for businesses underperforming and/or failing. And oftentimes the problems have more to do with not anticipating, recognizing and correcting issues that are "correctable". This is because there is an important financial skill-set that is missing from the company – sometimes unbeknownst to the business owner who may assume that these critical issues are being reviewed/attended to by other "accounting" people (bookkeeper, CPA, etc). In larger organizations, this skill set is typically provided by a CFO (Chief Financial Officer); in smaller companies, it is frequently absent.

Who are the "wrong people" and what exactly is wrong about them?

Let's start with a couple questions: Does your business have a CFO-level professional in place to protect the investment you've made in your company?

If not, whom in your company do you rely on to fill this critical need?

1. Yourself (the owner)
2. Your company bookkeeper
3. Your outside CPA
4. Nobody

Let's look a little closer at each of these alternatives, one by one.

Who are the "Wrong People" & Why?

1) Yourself (the owner). In most small companies, the owner is an expert in the product or service the company offers. He or she is usually involved in sales as well. Generally, these activities are the most productive use of the owner's time.

While the owner needs to understand the financial statements, it is not practical for him or her to have the level of understanding that an experienced CFO would have. After all, you didn't get into business to be a CFO; you got into business to sell a product or service. Every hour you spend trying to become an accounting expert is another hour you could have spent on your product, service, or sales. And even if you have the time, you're unlikely to have the skill of an experienced financial professional.

An Owner is Not a CFO

2) Your company bookkeeper/accountant. A skilled bookkeeper is critical to accumulating accurate data and "minding the store." Making sure payables are paid, receivables are collected, and records are accurate. Every company needs a skilled bookkeeper or accountant. Your company's accountant may understand the business from day-to-day involvement, but he or she does not have the experience to ask the right questions and assist the owner in critical decision-making.

The job of a CFO is to look at accounting data and interpret it. It's not about counting the beans; it's about interpreting the data to help the owner manage the business effectively. This requires skill, time, and desire. If your bookkeeper was capable of doing this, he or she wouldn't be a bookkeeper.

A Bookkeeper is Not a CFO

3) Your outside CPA. Your CPA is a critical advisor on how to structure your business, how to plan for and minimize taxes, and how to ensure that your financial statements comply with Generally Accepted Accounting Principles (GAAP). This is highly important advice. But it has very little to do with day-today "operational finance" — where profit or loss are determined and cash-flow is managed.

While most outside CPAs possess the skills to be an effective CFO, they don't have the time or desire. Additionally, they've probably never been an acting CFO before. Usually the outside CPA has a basic understanding of the business, but a CFO needs to understand the numbers on a much deeper level and on a more frequent basis.

A few brief meetings a year is not enough to really understand the company's business issues and reporting systems; and this is where money is made or lost. Taxes are merely a by-product.

You meet with your CPA around the end of the year. From January through April, he or she is drowning in tax work. So who's overseeing your finances between your annual visits to the CPA?

Your CPA is Not a CFO

4) Nobody. If you've never had a CFO, or someone who does the things a CFO does, you might be saying, "I've been in business for 10/20/30 years, and I've gotten by just fine without one." As they say in the investment world, "Past performance does not guarantee future results." The economy is ever changing. Businesses that once thrived are closing. Work is being moved to other countries. Margins are being squeezed. How will all these factors affect your future profitability? Simply hoping things turn out well is not going to make it so. An experienced CFO can use current data to look forward, so that problems — as well as opportunities — can be anticipated and planned for. As the following examples illustrate, operating without the expertise of a CFO can be a SERIOUS, UNNECESSARY RISK.

No CFO = Unnecessary Risk

Illustrations & Implications

With EVERY business we've worked with, we've uncovered CRITICAL information that no one inside or outside the company was aware of. Not the owner(s), not the in-house accountant, not the CPA. How is this possible? It's because ...

NO ONE WHO WAS QUALIFIED WAS PAYING CLOSE ENOUGH ATTENTION!

Here are a few real-life examples:

1. A manufacturing company was showing a HUGE net loss because the bookkeeper wasn't accurately recording earned revenue. The company didn't understand why there was a loss, nor could they explain it to the bank. The bank became uncomfortable and asked the client to leave — even though there was no fundamental problem in the business! Why? Because neither the owner nor the bookkeeper understood the unique accounting treatment required by this type of business. They relied on the outside CPA to make this calculation ONCE A YEAR!

2. An automotive-assembly company was overstating its bank loan collateral by more than 50 percent. The in-house accountant corrected this error ONCE A YEAR — just before the annual audit took place — but let it go during the remainder of the year. When the bank realized in mid-year that half of its collateral did not exist, the company was SHUT DOWN.

3. A professional services company was sustaining large losses due to billing less than 50 percent of the hours they actually worked. All of this data was collected and available, but no one running the company ever looked at it. They simply "hoped" things would turn around at some point in the future.

These examples are not isolated incidents; they are companies that have been in business for 10, 20 years or more. They are owned by competent people. The problem is that the owners are relying on the WRONG PEOPLE to provide financial oversight, management, and leadership.

You've invested considerable time and money into your business. Are you going to entrust the oversight of this investment to your bookkeeper? Or your outside CPA, who you see once or twice a year???

Success Keys

Two keys to relying on the RIGHT people: Capability and Involvement.

The two keys to relying on the right financial people are being capable and being involved. You need a person who is capable of doing the types of things a CFO does (see below). And, to be of any value, you need someone who is involved enough to understand what's happening in your business on a week-to-week basis.

A bookkeeper is involved enough, but not capable.

An outside CPA may be capable, but is not involved enough.

What exactly does a CFO do anyway?

In Short: Financial Oversight

A CFO looks at the financial information of a business and then determines what needs to be done. It's different for every company, but in general, a CFO would be involved in the following:

- Ensuring that the company's reporting contains data that is BOTH accurate and useful for decision making
- Bringing focus on the key items that have the greatest impact on profitability
- Instilling basic financial disciplines and controls
- Creating projections to identify future problems and opportunities
- Performing thorough financial analyses in order to make effective business decisions (For Example: How much overhead should be included in your pricing?)
- Assisting with outside relationships (bankers, vendors, customers, CPAs, etc.)
- Providing leadership and training to the company's accounting staff
- Questioning and challenging the status quo (e.g., not being satisfied with "that's the way we've always done it")
- Assisting the owner with difficult decisions

Can a Small Company Afford a CFO?

In most cases, the answer to this question is "No." An experienced CFO will likely cost in excess of $150,000 in salary and benefits. However, most small companies don't need a full-time CFO. There usually isn't enough work to justify having that level of expertise on staff full-time.

The Virtual (Outsourced) Solution

What if you were able to access the skill and expertise of an experienced CFO — and share the cost with other similarly sized businesses? Imagine having an experienced professional available to oversee your investment, provide leadership to your staff, and put in place the plans, tools, and controls to ensure that your business hits its targets — and there are no catastrophic surprises.

This can be achieved at a FRACTION of the cost of a full-time CFO, and will provide you with peace of mind, knowing that you don't have to try to be an accounting expert, on top of everything else.

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Summary & Resources

Strong financial leadership is one of the most important factors in business success, as well as avoiding the “#1 Mistake”. And outsourcing has now leveled the playing field, providing the same high-end skills to small businesses. In as little as two to four days a month, business owners can ensure that someone who is CAPABLE is INVOLVED and actually PAYING ATTENTION to protect their investment and maximize returns.

Visit www.michiganCFO.com for additional resources including webinars, articles, newsletters and media appearances.

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