mikephippsfinance

Business Plans and Cash Flows Explained

In the lead up to the GFC if you were upright and breathing and had a deposit you could borrow money. The banks were very excited about the way things were going and not a lot of attention was paid to the capacity of the borrower to successfully operate the asset being purchased. After all, the economy was going gang busters, the miners were having a great old time, what could possibly go wrong?

My, how things have changed !

The past few years have seen a steady tightening of credit policy among the banks with particular focus on new entrants to business with management rights and motels no exception. In fact, some banks will simply not lend to first timers regardless of how much deposit they have. Others are insisting on past experience and/or qualifications in a similar type of business. Most lenders are now enforcing a need for the dreaded business plan and cash flow in support of credit applications, particularly for motels and caravan parks. Never fear, it's not as bad as most people think. In fact, done correctly business plans and cash flow projections can actually be fantastic business tools.

Let's start with business plans. There are numerous templates and guides available on line and frankly most of them look horrible to me. A business plan should be a pretty simple document and certainly not one full of motherhood statements and vague suggestions around wonderful guest experiences and the like. For me, a business plan starts by asking some key questions and then answering them. Typically these will be the same questions you've asked yourself when making the decision to purchase. They include things like:

- What attracted me to this business in the first place?
- How is the business operating at the moment?
- Why are clients spending their money here ? If they are not, why not?
- How am I going to maintain current performance if things are going well or improve performance if things are not going well?
- What is my fall-back position if my plans fail?
- Can the business be improved and how?
- Do occupancy rates and tariffs seem about right or is there room for improvement?
- Who are my competitors and how can I steal some of their business?
- What's on the horizon that might present an opportunity or a threat?
- Do I have any regular clients, why do they stay and what happens if they stop coming?
- Are my key staff happy and reliable? Who are they?
- When am I going to be really busy or a bit quiet and how will I manage the business to cope?
- Do I need to invest money in equipment and capital items to maintain my standards and retain guests? If so, what and when?
- Will I have to promote the business and if so, how? What advertising and promotion is the current owner doing?
- Am I getting lots of business from third party channels? If so, what's our web site like and how can we connect with more guests directly?
- Have I sought advice from industry experts and if so, who? What did they think about the venture?
- If things don't go to plan who are my support team and where will I go for advice and guidance?

Mike Phipps. **0448 813 090**
mike@mikephippsfinance.com.au
Paul Grant. **0448 417 754**
paul@mikephippsfinance.com.au
Cameron Wicking. **0477 776 859**
cameron@mikephippsfinance.com.au

Head Office
4/31 Mary Street
NOOSAVILLE QLD 4566
Office. 07 5470 2194
Fax. 07 5455 6626
www.mikephippsfinance.com.au

MIKE PHIPPS FINANCE ACL (364 314)

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This is certainly not an exhaustive list and there will be questions peculiar to your specific purchase but it's a good place to start. Once you have answered these questions the outcomes pretty much become the assumptions that drive your cash flow forecast. We see cash flows from time to time with no assumptions. This is a bit like trying to read a map with no towns on it. You have a vague idea where you're going but no idea if you've arrived. Assumptions are pretty simple. They are the core operating metrics that will result in the cash flow you are forecasting. If you have a motel in a town with a big event each year you can assume 100% occupancy at a tariff say twice the yearly average for that week. That's an assumption. If you are operating a holiday building on the Gold Coast you can assume peak season tariffs and 95% to 100% occupancy over Xmas. That's an assumption. The council are planning to widen the road out front and potentially disrupt your business for 2 months. Occupancy may fall but you might also get the contractors to stay. That's an assumption. You have a motel lease with the rent linked to CPI, it's going up every year, that's an assumption. You get the picture.

We recommend developing your cash flow forecast in conjunction with your accountant. The first 12 months will include your cash contribution and the bank loan/s as a starting balance and reflect your purchase price, costs and any preliminary expenses you are planning to incur as well as the day to day operating income and expenses of the business. I see a lot of cash flows that are what we term as flat line. That is, every month is the same. In the real world business simply isn't like that so be sure to take into account specific operating dynamics on a month to month basis. This includes things like BAS payments and tax payments. I am also a fan of having a below the line personal cash flow that takes up all your personal expenses to give you a net cash position each month. We run a dynamic cash flow for our business that includes both personal and business expenses and also allows for future expected taxation and BAS liabilities. When we receive a bill we pay it and update the cash flow with the amount and timing of the bill. We do the same as our expected revenue changes. That way we keep track of costs and income as they change and we don't get any nasty surprises. We also find it useful to use the cell based notes function in Excel to make notes about particular income and expense items. At my age it's just too easy to forget otherwise and this saves me having to go back over countless files looking for a clarifying document.

All of this takes a little discipline but I suspect people who track their cash flows sleep better than those who simply pray that all will be well. Even if your projections don't always provide good news at least you can be prepared.

Mike Phipps
Director | Mike Phipps Finance.

mikephippsfinance

Mike Phipps. **0448 813 090**
mike@mikephippsfinance.com.au
Paul Grant. **0448 417 754**
paul@mikephippsfinance.com.au
Cameron Wicking. **0477 776 859**
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