Fast Finance Fundamentals for Food and Beverage

FOOD
SOUTH AUSTRALIA
FEEDING CONNECTIONS

MOORE STEPHENS

Fast Finance Fundamentals

How to use this resource

Did you know seven out of every 10 small to medium enterprises fail within the first six years, and a key reason for business failure is the lack of sufficient financial management skills?

In 2017, Food South Australia presented the Fired Up Finance! workshop designed to help food and beverage businesses gain a better understanding of the fundamentals of finance management.

As the state's peak food and beverage industry association, Food South Australia is committed to supporting the growth and success of South Australia's food and beverage manufacturers. One of our key objectives is to ensure businesses in our sector have access to expert support to help you plan for success.

This brief overview covers the essentials of finance reporting, cash management, and costing and pricing for food and beverage products. It has been developed for Food South Australia by Moore Stephens South Australia, who assisted with the presentation of the original Fired Up Finance! workshop, and is designed to provide you with a quick and easy financial management 'reference check' tool. Use it to help you quickly check you have your key financial information readily available and to identify any areas where you may wish to seek further advice to ensure your business is fully prepared for financial success.

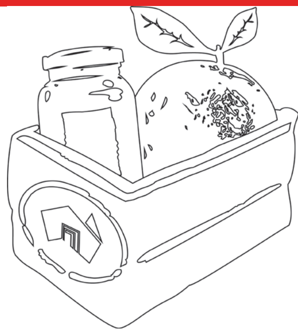
Need more help?

Food South Australia members can contact our office at contact@foodsa.com.au or on (08) 8303 9435 for more information and referral to expert service providers.

Not a member of Food South Australia? Membership of Food South Australia is open to food manufacturers, processors, and value-adding producers with the head office or majority of operations based in South Australia. Service provider membership is open to businesses currently providing products or services to the South Australian food industry. Membership is also open to industry associations representing South Australian food manufacturers and producers.

Contact us on (08) 8303 9435 or at membership@foodsa.com.au for more information.

1. Understanding financial reporting



How often do you review your financial results and why? Do you understand what to focus on?

It is not necessary to learn how to generate financial statements (we can leave that to the accountants) but it is critical to be able to analyse those statements to really understand the financial condition of your business.

Business leaders and managers have to develop at least basic skills in financial management. Expecting others in the organisation to manage your finances is clearly asking for trouble. Financial reporting and analysis shows you the reality of your business, and allows you to plan for the future.

The fundamentals

- The profit and loss account simply represents the results of operations over a given time – month, quarter or year.
- The balance sheet gives you a financial snapshot of your business on one particular date and time, and shows the cumulative record of business activity since the day the business opened to the present.
- Assets always equal your liabilities plus your equity as an owner, i.e. for every dollar invested in assets, someone had to supply that dollar.
- Retained earnings are cumulative since the day the company began, and are generally not cash.
- Finance ratios are tools you can use to analyse your business in different ways, such as:
    - Ratios can look at your trends and compare your current performance with past years.
    - Ratios can compare your present performance to others in your industry (these are known as industry ‘benchmarks’).
    - You can also use ratios to strategically review your business plans and track your progress against your operating strategy.

What to check

1. I have considered whether my reports are useful and timely and have discussed my needs with my accountant.
2. I use my reports to understand what is driving my working capital cycle including:
    - Whether my creditor days are increasing or decreasing
    - Whether my debtor days are increasing or decreasing and how this compares to my payment terms
    - Who my slow paying debtors are
    - Where new sales have come from
    - Whether my stock days are decreasing or increasing.

2. Why cash is king

A supermarket chain wants your products which could significantly increase your sales. What could that do to your profit and more importantly cash position? And what happens to your cash flow if debtor days starts being collected in 45 or 60 days instead of 30 days?

The working capital cycle of your business goes something like this: you start out with cash, purchase some inventory, sell the inventory, issue an invoice, create an account receivable and, if you are lucky, the customer pays on time and you are back to cash again – cash you can use to purchase new inventory with some left over to pay your rent, staff and so on. This cycle works for every business in the world.

Every business owner needs to know what drives the working capital cycle in their business and what draws cash out of that cycle. Making the cycle turn faster or managing the cycle more efficiently will generate more cash for your business, and reduce the level of bank loans needed to supplement your working capital.

The fundamentals

- A growth in sales can impact your business - and not always in a good way. Growth means access to more cash, for example more stock (raw materials, work in progress and finished goods). You will need to keep your working capital cycle in check.
- A blow-out in your working capital can be caused by too much stock, too many debtors, poor creditor management or poor cash management.
- Businesses need to focus on how to shorten the cycle and make a given amount of cash work better for them.
- Do not assume discounting your price is the only way to make cash work harder.
- Focus on receivables and terms of trade.
- Buy or invest in stock 'Just-In-Time' to avoid tying up cash and to ensure you keep storage and insurance costs down.

What to check

1. I have developed a debtors' management system.
2. I make sure preparing invoices is one of my highest priorities.
3. I provide my customers with information to allow them to make payments directly into my company bank accounts.
4. I actively monitor my stock levels and have considered reducing my stock levels.
5. I am minimising the amount of finished goods on hand.
6. I have decreased all stocks for 'safety' purposes.
7. I have looked for opportunities to make effective use of bulk buying discounts, including calculating their true cost using a discount rate formula.
8. I have considered implementing a 'Just-In-Time' system with a dedicated supplier for major inputs.
9. I have identified the value-adding processes in my business for my main products, and identified any areas of delay.

3. Costing and pricing food products

Do you know what your products cost to make and what price to sell your products for? Are you considering which products to continue and which to drop from your range? Are you aware of the volume of each product you can profitably manufacture?

If your business is making little profit or incurring losses it is important you look beyond the profit and loss statements. It's time to analyse the true cost of all your products and services to determine which ones are making you money and which are pulling on the purse strings.

You may find a product you thought was profitable is in fact making a loss, while another you thought was marginal is actually very profitable. To make things worse, unprofitable products generally sell really well because unwittingly the business owner has under-priced them in the market place.

So, as sales increase, so does the loss in net profit. By getting costing and pricing information right, a manufacturer with poor profitability can turn their company around. Resources can be directed into the products with higher profit margins and products making losses can be withdrawn, or efficiencies made to improve margins.

The fundamentals

- The total cost of a product includes three things: direct materials, direct labour and overheads.
- Direct labour costs include the total wages, superannuation and allowances of all employees.
- The chargeable hours for each employee are estimated for the direct labour costs, allowing a 'labour charge out rate' for each wage level to be calculated.
- Overhead costs are calculated by listing all of the costs not included in direct labour or direct material and estimating their future cost.
- The price of your product should include a mark-up. This varies between industries, but for the food industry should be in the vicinity of 5% to 15%. (
- Markup and gross profit margin are not the same thing. The markup is the difference between the cost and selling price, and is expressed as a percentage of the cost. For example a cost price of $100 and a sales price of $140 has a markup of $40 or 40%.
- The gross profit margin is the difference between net sales and the cost of goods sold, and is expressed as a percentage of the selling price, so a sales price of $140 (100%) with the cost of goods sold of $100 (71%) leaves a gross margin of $40 (29%).

3. Costing and pricing food products

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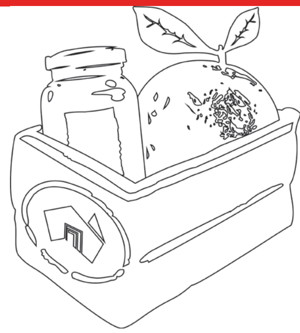

What to check

1. I have calculated all of my direct material costs required in my manufacturing, including freight, packaging and use of subcontractors.
2. I have allocated my direct materials based on how much I use them.
3. My wastage and spoilage costs are incorporated into the material usage.
4. I have allocated direct materials that have no direct relationship to the product to the overheads.
5. My special machinery and equipment used solely for selected products have been allocated to those products only.
6. I have included wages, bonuses, commissions, special allowances, superannuation, payroll tax and workers compensation in my direct labour costs.
7. I have calculated the labour costs across the various categories of personnel in my business.
8. I have realistically costed my overheads, including considering whether they are a one-off or unusual payment, (in which case I have excluded them).

4. Finance for decision making

Are you confident to make adjustments to your business to create value and avoid burn-out? Do you focus on your profit targets rather than sales? What will your profit and loss, and cash position look like in the future?

The primary purpose of having accurate and timely financial information is to make informed decisions about your business. Any other use is secondary. Navigating business based on half the picture or 'gut feel' is a very risky strategy and can result in business failure. In fact in our experience businesses making uninformed decisions generally only survive when profitability is high enough to pay for those wrong decisions.

The fundamentals

- A 'budget' is a set of income and cost expectations set (in advance) for a particular period.
- A 'forecast' is a review of the budget during the budget period.
- Budgets should not be administered rigidly. Changing business conditions usually call for changes to your plans.
- Budgets promote coordination and communication within your company, and can help motivate owners and employees.
- Budgets provide a framework for judging performance and facilitating learning.
- It's important to consider what financial information you will want to share with your team during internal meetings.
- Banks now routinely expect to be provided with a greater level of detail about your business forecasts.
- If you are considering a price discounting policy, you need to consider the increase in sales needed to compensate for it, based on your present gross profit margin and the percentage by which you wish to reduce your price.
- When pricing your products, you need to determine the percentage of sales that could fall as a result of a percentage increase in price.

What to check

1. I can analyse and critique any variances in my financial reports and predict the impact of these variances.
2. The data used to create my financial reports is of the highest integrity and I can therefore use this information with confidence to guide my decision making and plan for the future.
3. I have access to detailed and specific reports on each of my product and/or service lines to better understand their impact.
4. I have the ability to assess whether I can fund my new product as part of my business growth.
5. I can work out whether I can afford to employ a new salesman with the increase in sales shown in my reports.

Food South Australia is an independent, industry-led and membership-based organisation representing food and beverage manufacturing companies based in South Australia. Food South Australia is the peak body for the food and beverage industry in South Australia.

Our mission is to to grow markets, capacity and connections for the industry by providing business and market development support, and acting as a united voice for South Australia's food and beverage industry.

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This resource was prepared by Moore Stephens South Australia on behalf of Food South Australia.

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