7 things you need to do when your business is failing

John Fordham is a management consultant and business advisor with decades of experience in helping turn businesses around to become profitable, in this article he shares tips for what to look for and what to do when you find the the business you are working in is struggling.

If you have ever worked in a business that's struggling you'll recognise there comes a point when it's time to stop, take stock and ask where do we start?

1. Manage and act on the Gross Profit indicators

This is the big one. Poor understanding and management of gross profit, followed by necessary actions to achieve profitability is usually the major cause of company failures. Gross profit is the figure arrived at as follows; Sales income – less materials, production consumables, packing and transport – less direct labour costs = gross profit value. The percent figure should always be shown as well for the trend and analysis purposes. The GP figure should be what I call 'clean gross profit'. This means not including depreciation, or quality control, or odd overheads that I have found some accountants have included, which then distorts the trend. The gross profit percent would typically be between 30% and 40% for many companies. The gross profit is the figure, which shows the money you have made from the business. The money is then used to pay for all the overheads and make a profit. In summary, down to the gross profit figure in the accounts is where you make the money; below the gross profit figure is where you spend the money.

The percentage trend for product materials and direct labour must be monitored. If the materials percent (against sales) is increasing, does that mean sales prices are declining? Or have materials/product increased? Or labour? This percent should ideally be maintained and even decreased with better automation and systems. Here find alternative suppliers, or supply and material changes, reduce wastage.

2. Review product percentage margins

Having looked at the overview of GP percent, it is then necessary to review all margins. Just print out the sales and direct costs data for all products. Then rank them from worst percent margin at the top to the best at the bottom. This will clearly show which are all the loss makers to take action on. Basically anything below 20% for example. In simple terms, raise prices on the loss makers or stop selling them, or sell/offer an alternative.

3. Identify customers' sales totals

After finding the loss makers, rank the sales by customers and find their loss makers. This information can normally be achieved by using the above product information and then ranking accordingly. For impact again rank from worst to best so that companies and their loss making products can be identified for taking action. Then raise prices or cut. Both of these need to be done with care and planning.

4. Raise prices

I have found that some companies have not raised prices for years and do not know how to. Obviously, if possible, new prices should be competitive with similar competitors or products. You need to fully understand your costs, minimum percentage margin required and progress from there. If you can, benchmark your product and prices against competition to discuss with customers. One company I took over to manage had been losing money for 10 years because prices were too low. We increased prices, improved customer service, and production efficiency, and went quickly into profit.

5. Improve cash situation

Debtors. Many companies don't chase customers for the money. Some debtors are outstanding for 60, 90 or more days. You are entitled to ask for the money within 45 to 60 days. If sales are £1M in a year, the sales are approximately £3,000 per day. So 60 days of debt would be £180,000. If debtors slip to 90 days that is an extra £90,000 tied up.

Creditors. I have seen companies paying creditors in 30 days and collecting the debtors in 60 days. Ideally pay creditors in 45 days and collect the debts in 45 days.

Stocks. Stocks should be no more than 6 to 8 weeks of sales depending on the supply chain. Ideally not more than one month. If you have £1M sales company, with material costs of say 25%, with 6 months stocks that is £125,000 tied up. If you get that down to 2 months, that is £42,000 in stocks which saves £83,000 for investing on efficiencies.

Cash saving for a £1M company with better debt collection, and stock reduction could increase cash by £100,000.

6. Review staff performance

Meet and discuss your team's jobs with them. It is amazing what they tell you to enable you to improve the business. Who are performing well? Who are not? What training is needed? Has the sales person had sales training; are they capable of improving. Talk to people on the shop floor. There are often people who have ideas for improving efficiency. Set up discussion groups. Your sales people and marketing people need to be clear on selling benefits not just features.

7. Cut overheads

If the company is floundering and there is reducing gross profit to cover overheads, then overheads must be cut. Of course it's not easy but actions can be laying off staff, closing premises or space, or sub-letting and renting to save money.

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