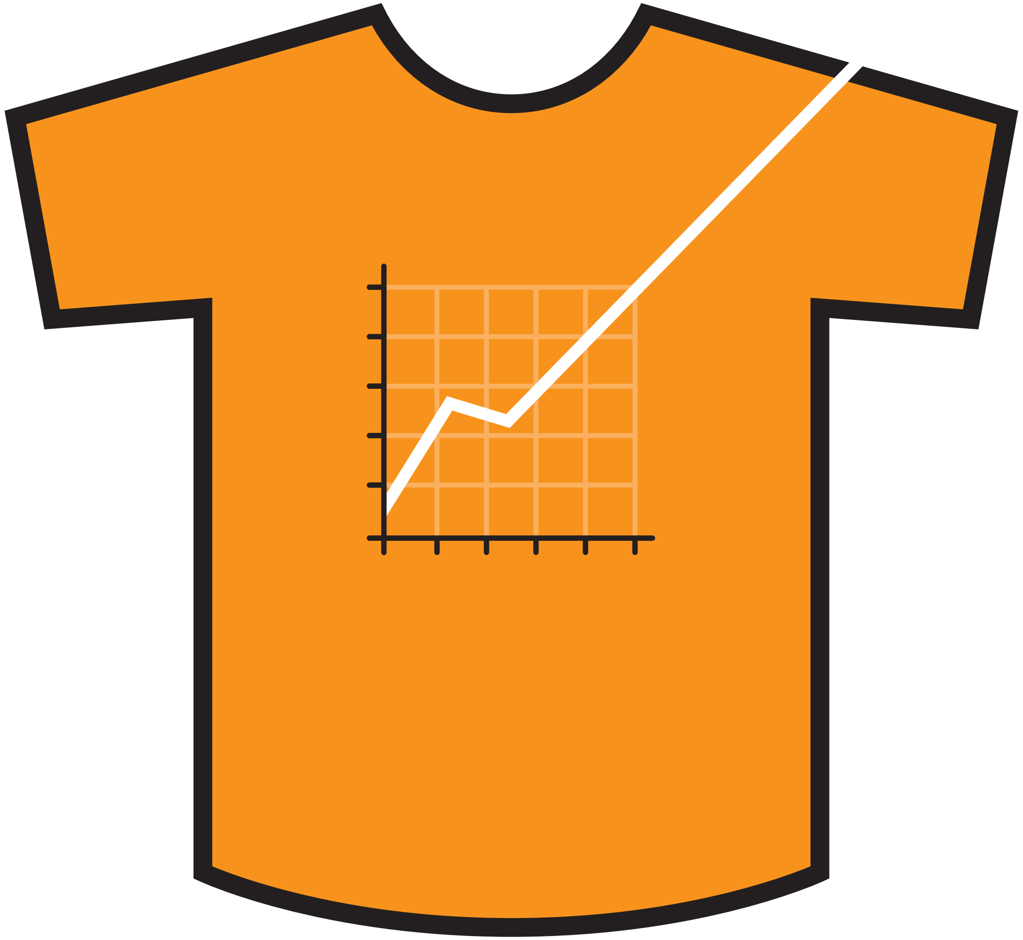
Counting your Money

An excerpt from ‘T-Shirts and Suits: A Guide to the Business of Creativity’ by David Parrish



This chapter emphasises the importance of understanding and monitoring your enterprise's financial health by looking at financial measures from three different perspectives.
It also covers raising funds and the importance of generating future income streams both for investors and your own long-term financial security.

‘success stories often start from meagre beginnings’

This financial section applies to not-for-profit organisations as well as commercial businesses. In fact in my own experience it sometimes requires more financial acumen to run a social enterprise, balancing creative or social ideals with economic pressures to achieve the required financial outcome.

When I ask businesses about their weaknesses, usually one of the first answers I receive is “we don't have enough money!” Clearly, a critical lack of cash is a problem for any business or social enterprise – new or established – and it can present barriers to thriving or even surviving.

The financial barriers are real – or sometimes imaginary. ‘Imaginary’ in the sense that people often *imagine* that to start a new business requires immediately having all the assets and trappings of a well-established enterprise: equipment, offices, vehicles etc, when very often it needs less than they think. The question is not so much: How much money would we like ideally? A better question is: How little do we need to make the enterprise feasible? (either a new business or an additional venture). Waiting for the day all the money arrives, from the bank, a funder, or the Lottery could mean it never happens. Success stories often start from meagre beginnings. Equipment can be hired or borrowed rather than bought new, vehicles rented, offices can be shared (or virtual) and professional services can be traded. Growth can be organic rather than a sudden step-change and managing on low overheads can be not only a useful discipline in the early days but also the basis of a sustainable long-term financial strategy.

Being clear about how much is needed – for capital expenditure and working capital – is essential. Minimising purchases of equipment reduces funds tied up in fixed assets and cash remains free to provide the life-blood of a business ie working capital – the money pumping through the bank account to enable essential everyday payments to be made. If this working capital is insufficient, the business could collapse despite having profitable projects in the pipeline.

Three Ways to Count Money

The three ways of looking at the finances of any enterprise are through **three financial windows**, the Income and Expenditure Account, the Balance Sheet and the Cash Flow. Each of these can be reports of past activity or projections anticipating a future situation. Each tells its own story and helps to plan a successful future: the creative entrepreneur needs to understand and use all three.

The **Income and Expenditure Account**[17] shows the profit made over a particular period, usually one year. (Even for not-for-profit organisations this is a crucial concept. The co-operative movement prefers the word ‘surplus’ and this term can be substituted throughout the rest of this chapter if required.)

The **Balance Sheet** shows the total value (net worth) of a business at a particular point in time. It's a ‘snapshot’ of the assets, liabilities and equity of the owners. The balance sheet indicates the financial strength and capabilities of a business.

The **Cash Flow Report** shows where cash came from and went to in the past. Crucially, a cash flow projection indicates when cash is likely to come and go in the future, on a monthly or weekly basis in the foreseeable future. A cash flow projection is a vital tool of financial management.

17 The Income and Expenditure Account can also be called a profit and loss account or income statement.

> ‘turnover is vanity but profit is sanity’

Financial accounts are the reports for legal and tax purposes and tend to be produced long after the event. In contrast, management accounts are for managers to use in real time. It is the information you need, when and how you need it, to enable you to keep an eye on what's happening and guide the business through good and bad times.

Cash Flow – or lack of it – is the quickest killer so the management of cash flow must be of most immediate concern in day-to-day management. As long as cash flow is healthy then rises or falls in profitability can be survived, though unprofitable activities will hit cash flow sooner or later.

It's vital to manage the cash flow but essential also to understand the profitability that creates cash. An effective business person knows the profitability of each project in the enterprise, not just their combined total.

Each project or department needs to make a contribution to the overheads of the organisation as well as cover its own direct costs. Or to put it another way, a proportion of core costs need to be allocated to each project or department.

The balance sheet shows the value of the business at specific points, past, present and future. This is public information for a limited company and gives outsiders a statement of the net worth of a company in terms of fixed assets (equipment and property), current assets (cash and bills receivable), and current liabilities (overdrafts and bills payable). It is against these assets that the company might want to borrow funds.

Many creative and cultural enterprises focus on sales (turnover) instead of profit. As they say, "turnover is vanity but profit is sanity". Even for social enterprises where profit is not the prime concern, losses can be fatal. Clearly, profit is derived from the difference between income and expenditure so the control of costs is essential too.

Controlling Costs

There are two kinds of costs to control. Firstly **variable costs** (the costs that will go up and down depending on the level of sales), because reducing variable costs will help make activities and projects more profitable.

Secondly controlling **fixed costs** (the costs you are committed to paying whether you're busy or not) will help avoid cash flow problems and potential disaster during the leaner times. Low fixed costs also enable you to be less dependent on constantly high sales and so less desperate to bring in cash at any cost – for example having to do unprofitable projects for non-target customers – see **Mando Group**. Use your cash flow forecast to see how soon a cash crisis could occur if business hits a temporary downturn with different fixed cost scenarios. Being able to survive the bad times sometimes amounts to having a philosophy of keeping fixed costs as low as possible.

One of the biggest costs is staff time and so this needs to be monitored to get useful management information, control costs and increase profitability. Romanian branding company Grapefruit uses an automated system to record staff time spent on projects, good practice learnt in the USA by the company's Chief Creative Officer, Marius Ursache.

Raising Funds

Raising funds is essentially a job of persuading investors that they will get a return on their investment.

This applies whether it's a bank that needs to know how you will be able to repay the capital and interest, or a shareholder who needs to predict a return on investment from profits and dividends. A public funding agency will need to be assured of your long-term survival so as to maintain 'public benefit' in order to justify their investment from the public purse. (Financial viability may include match-funding from other sources or a degree of self-generated income.)

> ‘keep an eye on the profitability and cash flow dials’

So whichever way you are looking for funds, the starting point is not the application form but the creation of a feasible business formula, in other words a sustainable ‘business model’, which will provide predictable financial results. It is essential to get the business formula right in the first place before writing it up into a business plan. **Mando Group** obtained a number of loans on the basis of its business plan, as did **JAB Design**.

Predictions involve risk and the degree of predictability depends on the investor’s attitude to risk. Investors are often risk-averse and will require a charge on your assets. Intangible assets such as intellectual property are notoriously difficult to use as security. Banks will insist that the risk is partly yours by taking guarantees based on your business assets or personal property, whereas venture capital firms will generally accept more risk but expect a greater payback in terms of a large slice of your business.

There are numerous schemes to provide start-up grants or loans for specific types of business in particular regions. They change so frequently that it is not worth being specific here. Seek financial advice from professionals, mentors, friends and support agencies to apply to loan guarantee schemes, to take advantage of tax breaks or to obtain partnership funding. It’s worth noting that as well as collecting taxes, HM Revenue and Customs also provide extensive help and advice. Business support agencies will have up-to-date advice and their contact details can be found on the website.

It should be noted that there are always conditions attached to grants and loans and the application process can take time and possibly delay projects. In the worst cases I have seen inappropriate grant aid push organisations in the wrong direction. Sometimes businesses ask for help to get grants and loans when what they really need is a different business model to make them stronger and less dependent on grants or loans. It is therefore advisable to assess the disadvantages as well as the advantages of grants and loans before deciding whether or not to apply for them.

Your Financial Control Panel

Finance and accounting are often regarded as the boring side of business by creative people, but those who ignore it are not in control of their business destiny. It’s like driving a car without looking at the dashboard. Successful entrepreneurs don’t need to look at all the detailed financial information but do need sight of the key financial measures. These are the equivalent of the car’s dashboard instruments showing the important information such as speed, fuel and oil pressure. The financial equivalents are profitability (per project and overall), cash flow and net assets.

What each enterprise needs is a simple but effective **Financial Dashboard**, constantly visible when driving the business. More sophisticated measures include financial trends and ratios. Unless you have one eye on the profitability and cash flow dials, you’re heading for a crash – or an empty tank in the fast lane!

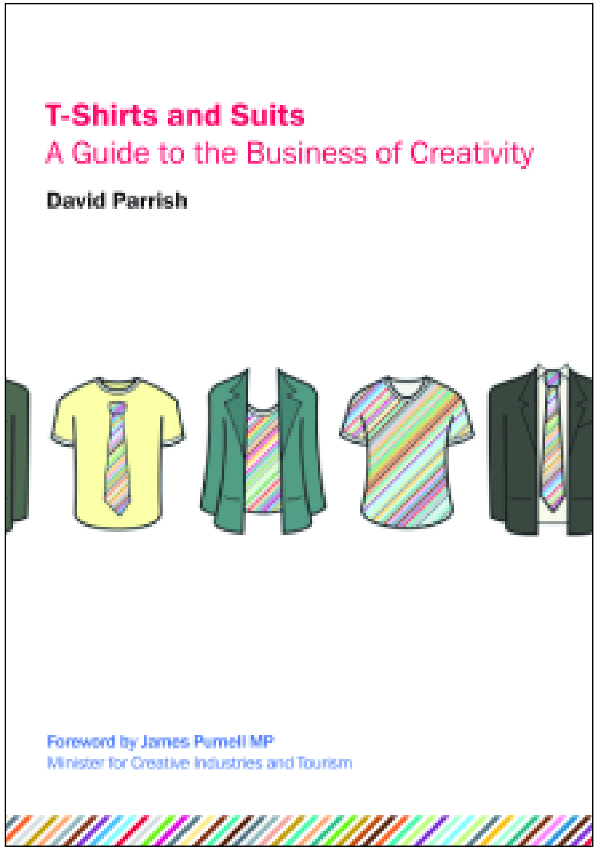
A more comprehensive **Business Dashboard** will take into account other vital indicators as well as the main financial measures.

Creating Financial Security

Financial security is derived from creating income streams that are not dependent on your continuous labour. These are the income streams that flow while you sleep. The things that create this cash flow can also be sold at a later date. In the creative industries, this is most obviously achieved through the utilisation or exploitation of your intellectual property. Intellectual property rights, managed skilfully, enable a creator to receive ongoing income from a variety of sources.

In a nutshell, the business of creativity is the art of turning creative talent into intellectual property that provides income streams for the owners of that IP.

This is an excerpt from the book 'T-Shirts and Suits: A Guide to the Business of Creativity'



ISBN 0-9538254-2-6

The website associated with this book provides additional information, new material and further case studies, details of training and consultancy projects, a framework for a business plan, a glossary of terms and links to other useful websites.

www.t-shirtsandsuits.com

First published in 2005 by Merseyside ACME,
303 The Vanilla Factory, Fleet Street, Liverpool L1 4AR.
www.merseysideacme.com

Designed in Liverpool by Mike Carney – www.mikesstudio.co.uk