

Episode 2 Small Business Research Findings

Lance Pederson: All right thanks for joining us in another episode of Finance Coach Radio. I am Lance Pederson I'm the EVP of Operations in IT at Fairway America and I have with me today the President and CEO Matt Burk.

Matt Burk: Hello.

Lance Pederson: Well we have some exciting news today. We actually have just got back, it's hot off the presses, our research study that we had conducted on the things that were kind of frustrating business owners and we really wanted to get some better insight into what was going on out there. We've obviously heard a lot of media reports over the last couple of months and last couple of years during The Great Recession, but we really wanted some more insight into what was really plaguing the small business owner. And so we commissioned a study by a third part research group to do some digging in for us and we just got the findings back. So today we're going to be covering that and I'll have Matt kind of share some of the stuff that we found. So let's get right into it. So Matt what was the most eye opening finding of the research to you?

Matt Burk: Well there were a lot of eye opening things in there Lance but I'd say probably the one that stood out for me the most was that one of the surveys or studies that our group found was, and it was according to their Federal Reserve Board Survey, that only 20% of small businesses actually even keep financial statements, which I found to be incredible. I mean I have seen lots of businesses over the years that produce what I'd say are average at best financial statements but the fact that only 20% actually keep them I found astounding. And part of that same study was that the preparation of budgets and projects and forward-looking statements is even more rare; I mean I just found that amazing.

Lance Pederson: Yeah it's true. I mean if people if they're using financial statements to make business decisions it pretty much throws the whole notion of having a projection or a forward-looking statement in there that I could cash flow projection and things like that out the window. And that really

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was startling but the more you think about it I guess that is kind of how it goes, people are really busy running their businesses rather than keeping track of it.

So another interesting area that kind of came up was around the area of expenses and this is kind of one of those things that just creeps up on you, but share with us what they kind of came back with regarding expenses and small businesses.

Matt Burk: Well one of the studies reveal that since 2005 employer cost for employee compensation and benefits and related cost were up 15% on average and in many cases more. And I know from personal experience, just in our company for example, the cost of health insurance has risen. I mean it's pretty much a guarantee going up 10% to 30% annually. So the fact that that's up is causing lots of pain for lots of people.

The US Census Bureau was the source of this information but it came back that pretty much every type of business across the board expenses are up since 2006. And for example, wholesalers it's up 11.3%, professional services business expenses are up 17.4%. So essentially you have decreasing revenues in many cases and dramatically increasing expenses. Well I mean it seems pretty obvious in retrospect but it certainly is just causing lots of pain for lots of people.

Lance Pederson: Yeah especially that pinch on the profitability of the company. There's also some interesting stuff on just compliance and the cost of that it surprised me but after you think about it, it really makes sense it's just you don't realize how big of an impact dealing with and complying with all this regulation have. Share with us kind of what they found with that.

Matt Burk: Well one of the fallouts of all of the problems that we had and the abuses and accesses of subprime lending and securitization and lose money and underwriting standards that had decreased was that in the aftermath of all of that there's just been a dramatic amount of increased regulations in all areas of business. So from advertising law to employment law to pretty much anything you can think. And so one of

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the things I found really interesting was that that's making a disproportionate impact on small business owners. So the survey revealed that for small businesses with fewer than 20 employees the per employee cost of compliance, with all of the regulations is \$10,500 dollars and that's per employee, and this is for companies with fewer than 20 employees. It's less so for bigger companies that's still \$7500 on average for companies with more than 20 employees. To put it in perspective that's like buying a new Nissan Versa automobile for every employee of your company every year. I mean so just a staggering cost of trying to comply with regulations. I found that to be a very interesting statistic.

Lance Pederson: Yeah and that's even before this whole 1099 thing comes down the pike, which they're feverishly trying to get that overturned, but just think about all these other things that are coming and all the paperwork that has to be processed, really for nothing adds no value to the business. It's pretty much going to probably go up to buying everyone a new minivan every year by the time we're done.

Matt Burk: Yeah. I hope that that one doesn't make it through.

Lance Pederson: Yeah.

Matt Burk: It's looking like maybe we'll get by without it but.

Lance Pederson: Yep. And then the other area that the research really hit on was just how time intensive, and how much time business owners put into running their business, and how much it really permeates every aspect of their life. Share with us kind of what the research showed on that.

Matt Burk: Well that was a Gallup Poll that surveyed small business owners and self-employed people. And according to the poll the average business owner is working 5.6 days per week with 62% working more than 50 hours and almost a full quarter of people working seven days a week. So it's just small business owners, you know, the old myth of you get into business so you can kind of take control of your time and the reality

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is, backed up by research, is that this is not true business owners are absolutely swamped and overworked.

Lance Pederson: Yeah. And they also got people to kind of reveal how much they're working while they're actually spending time with their family. Something like 43% of small business owners are still working even when they're supposedly not working, which is interesting and I think we all could probably admit to doing.

Matt Burk: Yes almost half of all small business owners are working during hours spent with the family and so people are spread really thin.

Lance Pederson: Yep. The other thing that they found that I never really heard of or seen much of but the research kind of shows otherwise is this concept of day lighting. Can you explain what day lighting is and what that means and the impact it's had on small business owners?

Matt Burk: Yeah. I mean cash flow pressure is really mounting for small business owners with expenses up and revenue is down and compliance with all the regulations. And so one of the studies found that 34%, a full 1/3 of small business owners are day lighting, which means they're taking park time work outside of their own business to make up for cash flow shortages. So here you have a 1/3 of all business owners taking on outside jobs outside of their company on top of being overworked. I hadn't heard of it either but a rather amazing statistic.

Lance Pederson: Yeah and I think they called it the Ping Pong Syndrome. It's just that there's so little there in their line of business for a 1/3 that they really have to kind of find other ways to bring money in to keep the thing going which is very interesting. And then kind of one of the really eye opening things I guess for me, it was probably even more eye opening than the 20% of businesses key financial statements, was just what people are resorting to doing. And I guess it makes sense but I guess what I'm referring to is embezzlement and really how widespread embezzlement has become in over the last few years I suppose, but

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even more so over the last 20 years, which is odd. So share with us what they found about embezzlement.

Matt Burk: Yeah. Well nationally embezzlement cases rose by 39% in the decade from 1990 to 2000, which of course precedes The Great Recession. But as recently as 2007 there was an estimated 22,400 arrests for embezzlement. And when you think about that if you only have 20% of small business owners even keeping financial statements and working six or seven days a week and being spread so thin it makes sense that many owners who are victims of embezzlement can't really even track it down or know what's happening until it's too late you just don't even realize it's happening. So that was a little bit of a scary statistic.

Lance Pederson: And weren't you having a conversation too just a couple of weeks ago with one of our colleagues Rich Denman, wasn't he speaking to the area that he thought was really in bad shape for most small business just the notion of cash controls?

Matt Burk: Yeah I'll give you two little anecdotes. One a client that I visited not long ago was talking to me about how he had had an employee that had been there for six or seven years and he really trusted the person. And then he came to find out that she'd been stealing from him and had upwards of a six figure number over a period of time and it really set his business back. And actually I think Rich and another gentlemen that I talked to who's in the kind of turnaround business, and so forth, was saying that the single biggest issue for small businesses is poor cash flow management controls and so forth, which leads to embezzlement and getting stolen from and so forth.

Lance Pederson: Yeah.

Matt Burk: I mean the single biggest cause of small business problems.

Lance Pederson: Yeah and so with all that said, I mean ultimately we're kind of hitting on it here, but the effect of all these things really have their toll on is just cash flow. I mean cash flow is if people have taken the money, if you're

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spending more out in expenses and all those things then you have less cash. There's some interesting and very shocking things about cash flow, tell us about that.

Matt Burk: Well one of the studies it was US Bank Studies showed that 82% of business failures were due to poor cash flow management which really backs up things that I've heard anecdotally and experienced over our 20 years in doing this, poor cash flow management just causes lots and lots of failures. I'm sure many people have heard the statistic that there wasn't in our particular study...

Lance Pederson: Sure.

Matt Burk: ...but you hear all the time is something like 95% of businesses don't last five years and of those that do last five only a couple of percent actually make it to the 10 year mark. Well when you start putting some of these pieces of the puzzle together...

Lance Pederson: Yeah.

Matt Burk: ...it makes a lot of sense. And one of the biggest problems is cash flow management.

Lance Pederson: Yeah. And I always like how Vern [Harnesh] with Gazelles put it is cash is like oxygen in their room. And when you really think of it that way it does put it in perspective. If we take all the air out of this room we're not going to live for too long and that's the same effect that cash has in your business, so it really does make sense. But rather than just saying "Why don't you improve your cash flow" it's interesting to see some of these symptoms that that lead to the bigger cash flow problem and that ultimately have to treat the root of all these symptoms, and we'll be getting into that in a minute. And as we know when cash flow gets tight in the first place is that people run to the bank in hopes that they can help them out. So how are most people fairing when they're going that route?

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Matt Burk: Well the statistics didn't look so hot there either. In 2010 on cash flow based loans the reject rate was 72%, for collateral base loans the rejection rate was almost 50%, 46.7% and on real estate based loans, which is the industry of course that's gotten hit the hardest, the rejection rate in 2010 was 90%. So 9 out of 10 loans got rejected. So high default rates and other poor sloppy underwriting practices over the last several years have really forced lenders to tighten their lending standards and that's making it much, much more difficult for businesses to acquire capital that they need.

Lance Pederson: Yeah and then the other interesting thing too was just looking back through history of bank closures as an example and there's basically none for the entire first six years of the decade of the 2000s. Tell us about what happened after that?

Matt Burk: Well in 2008 it started and then it skyrocketed in 2009. Since 2006 there's been 387 major banks that have closed in the United States and that number is growing as we speak.

Lance Pederson: Yeah. And that certainly doesn't make it any easier when you're a business with cash flow problems and you're trying to save the thing and keep it going and...

Matt Burk: And you're working 50 hours a week.

Lance Pederson: ...working 50 hours.

Matt Burk: And your expenses are up and your compliance costs are through the roof.

Lance Pederson: And your bank went out of business...

Matt Burk: Exactly.

Lance Pederson: ...which you don't think is going to happen but it's happened to a lot of people and that's just another factor. So the bad news about all this stuff that the research really showed too is that a lot of this stuff, and we kind of alluded to it as the cash moving in your business, is that it

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leads to the two letters that most business owners don't want anything to do with. What are those two letters?

Matt Burk: BK, bankruptcy. And so the business bankruptcy filing since 2006 according to the US Bankruptcy Filings have increased by over 200%. So in 2006 there were just a little bit under 19,000 business bankruptcies and in 2009 there were over 60,000 and another 58,000 in 2010. So it's up considerably.

Lance Pederson: Yeah. So it seems to be kind of leveling off but I think that the toll of The Great Recession it really wiped out a lot of businesses. I mean the good news may be that for those of you that are still hanging on or the businesses that are still out there the worse is probably passed us, but it really kind of shows that the inattention to those other things it can really wipe you out.

Matt Burk: Yeah one of the interesting things also that came out was since The Great Depression it's been very, very rare that more businesses closed than opened during any given year. And in the period 2008/2009 145,800 more businesses closed than opened, which is not very common at all going back in history, so you see the toll that it's taken on the small business community.

Lance Pederson: Yeah and especially given that with all the stimulus packages and other things that have been supposedly trying to reverse that trend just it's not good news when we have more businesses shutting their doors than opening. In which I guess is what comes back to what we're really passionate about is we want to see the small business not only survive but to thrive and so hopefully we'll see a reversing trend here in 2011.

So I know that we've put together an extensive action plan to combat a lot of these threats and frustrations that we've just covered in our Executive Briefing that you can learn more about on our Web site where we kind of cover okay that's great but what to do about it? But what would your one overarching piece of advice be for our audience? How do you deal with all these things that we've discussed these findings that

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have come out? I mean what can you do to kind of reverse these trends so to speak?

Matt Burk: Well there's a number of things that people can do but I'd say that at a real high level you can't correct course overnight right, it takes a period of time in order to be able to effectuate change in somebody's business. So I'd say a real high level is just for people to be more strategic. I mean think more strategically and do a better job of planning in advance for running your business. So one of the surveys or studies that was in the research that we commissioned showed that only 49% of companies have any strategic priorities at all. I mean they have no strategic priorities and even of those that do over half of those executives don't feel that they'll succeed. So I'd say businesses that actually take the time to do some strategic planning and some advance preparation have a far greater chance of being in the minority of those that succeed and thrive over time.

Sales and Marketing expert Chet Holmes, who we really have gotten a lot of value out of, talks about the most effective executive and he says that his belief is 90% of executives are tactical. So they just have these series of tactics that they engage in that don't really tie together and they just throw an ad in the paper and put an ad in the...

Lance Pederson: Sure.

Matt Burk: Or let's try this or let's try that without any strategies, tie it together, and only 9% are strategic. And then he says only 1% are both strategic and tactical, meaning that they can think at a strategic level and then execute at a tactical level based on some sort of a strategy. So more than anything else I would say just try to think more strategically about your business and do a better job of planning ahead.

Lance Pederson: Yep. And that is the good news for a lot of people is that you probably fall into the 90% crowd of you're just more tactical, which is kind of what the research showed right, it's not that they don't want to or not that they're not hard workers they're definitely are hard workers, it's

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that getting it down on paper and kind of being prepared and making sure that all those things are in place they tend to fall down on. And so if you're in that group I think it's actually a good thing because all you really need to do is just add some more strategic thinking to your already very tactical nature and you're there. Where the guys who are the 9% that are strategics sometimes they really struggle with the tactics. So I think there is a silver lining to that.

Matt Burk: Yeah and there's some steps that can be taken, of course that's some of what we're really working on and just trying to put together or as you say all this stuff is great and it's a little scary but what do you do about it?

Lance Pederson: What do you do about it, that's right? And the kind of last thing too that we found that was interesting just kind of a side note was a stat about the exiting and selling of your business. Do you want to share that as we wrap up?

Matt Burk: Yeah the studies found that as much as 50% of small businesses surveyed would like to sell their business in a given year and only 1% successfully do it. So that's a really telling statistic because only 1 out of 50 actually is in a position to be able to sell their business and act as if they want to. So I would just say in light of all the research, I mean all of the things being equal, businesses that have complete financials and documented histories and really have more strategic bent to them will have a tendency of course to sell much faster and for much higher valuations than those that just don't do those things.

Lance Pederson: Yeah. And that is it's always the dream, why did you get into business? I got into business so I'd have more time more freedom.

Matt Burk: Exactly.

Lance Pederson: Why else? Well maybe one day I can sell the business. And it's interesting when you look at those things. Or like Mike Tyson always said "It's I have a plan until the first punch is thrown and then it's just

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no hold bar from there." And I think that's what happens to most of us as small business owners so.

Matt Burk: Well the research would back that up.

Lance Pederson: Yeah.

Matt Burk: I mean this is all hard research that isn't just anecdotal this tells you what reality is.

Lance Pederson: Yeah. It's been great. We're really excited about this study and I think it does firm up some of the things that we thought and other things that we didn't realize, but ultimately we had this study conducted for us because we wanted kind of an unbiased third party look at what is really going on out there. And sometimes just by reading the newspaper articles on the internet and whatnot, with the media I guess, it's just sometimes it gets a little clouded. And I think that to really affect change and help these small business owners, which is what we're passionate about, we need wanted to understand really where they're coming from. So if anything that's what we've learned by doing this.

So if you want to learn more about the research and whatnot just visit our Web site at www.fairwayamerica.com we'll have a lot of the stuff up there and you can get access to it. And I kind of alluded to an Executive Briefing that we're doing where we're actually sharing the findings in detail, as well as what you really can do about these things and to overcome this stuff. So we're excited about that and we're getting that of the ground here in the next couple of weeks.

So that's it for today. Next month we'll have a guest speaker which we're excited about. So just stay tuned until then and once again just visit our Web site. If you have any questions we have a Contact Us Form and we'll be glad to help you out. Thanks again Matt.

Matt Burk: Thank you.