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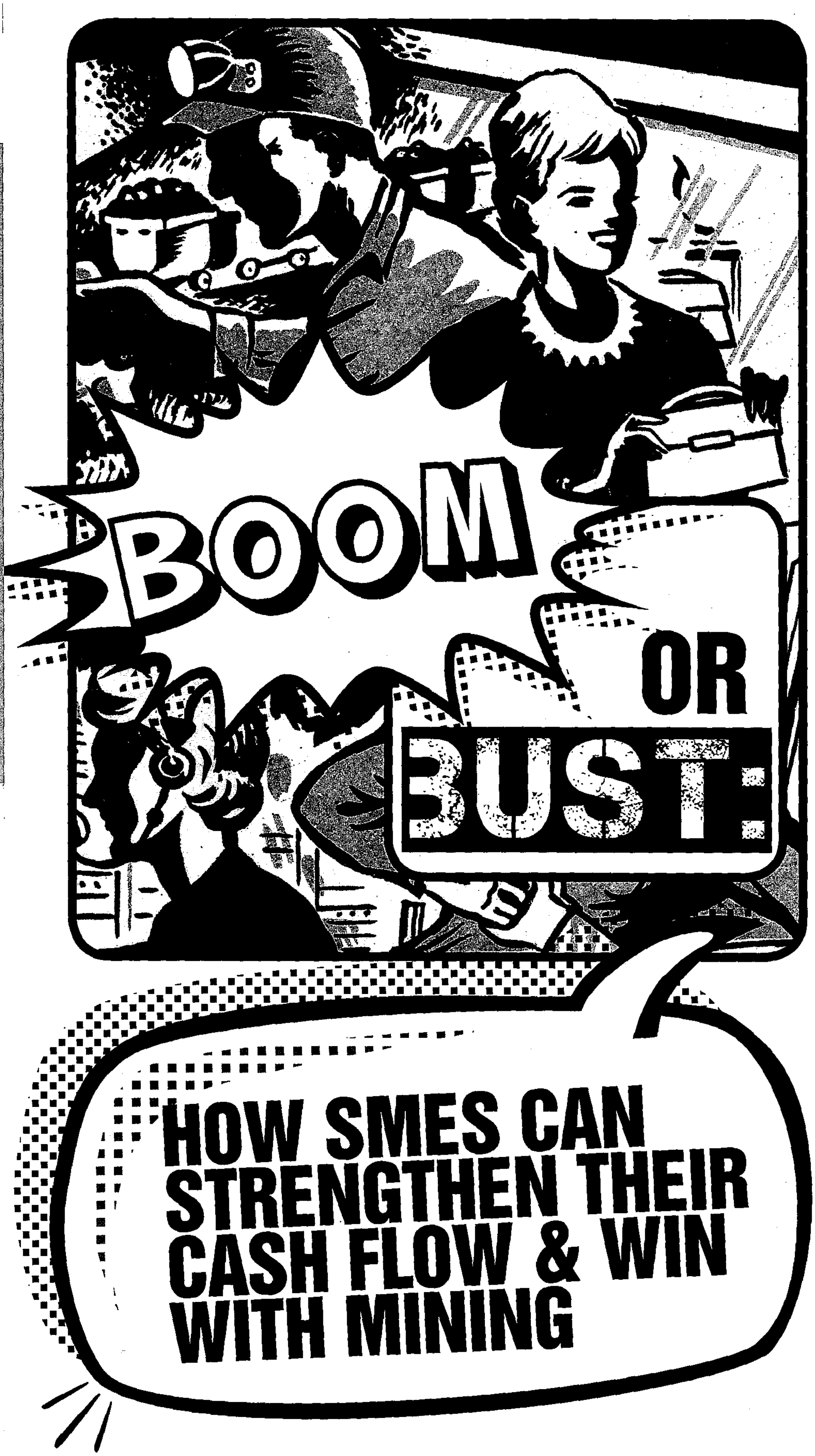

Most small businesses don't die of starvation, but rather as a result of gluttony. SME business owners who operate in the mining and natural resources sector are undoubtedly the envy of their peers in struggling industries, such as retail and manufacturing, where growth has been anaemic. Growth, however, has its own challenges – take the following case, involving an SME that clears vegetation for companies that are building pipelines as part of mining and energy projects, as testament to that.

Their operational base is in Queensland and their business was hard hit by the floods in early 2011, which forced them to fall behind on their obligations to suppliers, including the Australian Tax Office. Then, they received a significant amount of work as mining and energy construction activity recovered following the floods. This, of course, represented a great way for the business to get back on its feet, but there was one problem – cash flow.

Fortunately, the business owner has since found the cash flow to not just survive, but to thrive amidst the myriad of opportunities in his sector. Generating sales was not the problem – getting paid for those sales quickly was. We are not talking about bad debts here, just large company customers paying on time, but with long payment terms. In the mining and resources sector, the average time frame for suppliers to be paid is what is called "30 days end of month". This means that payment will occur on the 30th day following the month in which the invoice was submitted.

As a result, mining services SMEs must then be prepared to wait up to 60 days to get paid. But wait, it gets potentially worse for SMEs who have to pay their own suppliers on a 'Cash on Delivery' (COD) basis, as this creates a 'cash to cash' cycle of close to 90 days. Let's say the vegetation clearance business mentioned above has a contract for $100,000 of mulching and he starts the job on July 5. However, before he commences the work he needs to make repairs to his machinery and pay for petrol to run the machinery – all of these expenses are in cash

FOR SMES IN THE MINING AND MINING SERVICES SECTORS - WHICH MARK BOURIS HAS DESCRIBED AS TWO OF THE VERY FEW CURRENT 'RISING TIDES' IN BUSINESS IN AUSTRALIA - THE MINING BOOM REPRESENTS A ONCE-IN-A-LIFETIME OPPORTUNITY TO RAPIDLY GROW THEIR BUSINESS. DAVID HECHTER, OF FINANCIAL ADVISERS THE INTERFACE FINANCIAL GROUP, EXPLAINS HOW SMES CAN BEST MANAGE THEIR CASH FLOW TO ENSURE THEY PUT THEMSELVES IN A POSITION TO RIDE THE RISING TIDE OF THE MINING BOOM TO SUCCESS.

Then he starts the work, but he can only invoice once the job is completed, which he manages to do on August 1. He then invoices, but then needs to wait until September 30 to get paid. As a result, he is getting paid back 90 days after the time when he first paid for the repairs and petrol that were required for him to start the job – and this simplistic example avoided the fact that he would have to pay his staff fortnightly as well.

Small business owners are successful because they take on big opportunities and back themselves to find the resources to be able to deliver on those game-changing opportunities. It is this confidence and 'can do' attitude that makes SMEs successful. Unfortunately, these same traits are what leads them into trouble as their confidence can also blind them to the inherent risks of taking on new projects.

But SME owners can avoid this blind spot through shrewd, effective cash flow management. Here are five cash flow management tips that SME business owners can utilise to cope with the realities of having a growing business in an industry such as mining, where the payment terms are long.

1. Get your invoicing right

Working for the big companies in the mining industry sounds lucrative as the orders and/or projects carry large dollar sizes and the customers are financially solid. However, big companies are also bureaucratic, and this is particularly the case in the Accounts Payable department. One particular national mining company follows a process whereby invoices are approved at their mine site in north Queensland by the operations manager, then sent to their regional processing centre in Brisbane, and then onto the main Accounts Payable team in Perth. And one more thing – the invoices have to go via traditional mail as they require the originals. Snail mail indeed.

There is very little SMEs can do to change this bureaucracy, but they have to understand how it works and make sure that they comply. Several businesses have found out the hard way that putting the wrong Purchase Order Number on their invoice can mean a missed payment deadline that delays payment for 30 days or more. This leads into the next tip.

2. Hire a good office manager/book-keeper

SMEs that are successful at managing their cash flow usually have one thing in common – they have someone besides the owner taking care of the administration side of the business. Managing cash flow requires a company to be organised, and this means time in the office making sure accounts are updated, costs are tracked and invoices generated accurately. The remoteness of the work in the mining services sector means that business owners will unlikely be able to spend the necessary time in the office to meet the administrative needs of a business that serves big companies.

Having a strong Office Manager, Finance Manager or Administration Manager allows the office to function smoothly while the business owner is out in the field making sure that the work is done property and that business development can continue. If there is not sufficient budget to hire a full-time employee in this sort of role, then consider hiring a book-keeper who can fulfil these functions.

This individual is also essential to keeping the financial management accounts of the business up to date. This is important for a number of reasons, but becomes particularly poignant when it comes to finding external forms of finance to provide that working capital cash flow.

3. Visit your bank manager... if you own property

Where can mining services SMEs turn for finance? Many businesses will turn first to their bank, which is a logical choice. After all, you are already a customer of the bank and may very well have your mortgage with that same bank with which you do your business banking. Bank overdrafts can be very useful products as the business owner has the flexibility to draw down on the facility only when they need the cash. And also, the interest rates are quite competitive, albeit generally higher than the average mortgage rate because it relates to business activities, which are riskier.

However, the harsh reality is that many SMEs will simply not qualify for bank lending in today's economy. In order to achieve a bank loan – such as an overdraft – the business owner will generally need to have tangible property assets that he or she is willing to use as collateral for the loan. In addition, the bank will want to see a minimum of two years profitable trading history in order for them to validate the interest expense 'serviceability' requirements of the bank's Credit Department.

What will not work with the bank is showing up with a good story about having good customers and strong cash flow projections in an Excel spreadsheet. In today's post-GFC environment, banks will lend to small businesses with collateral, not business plans.

If the bank demands that property be used as the collateral, then SME business owners need to realise that the amount of the loan will be capped based on the value of the property (less any other mortgage loans attributed to that property). An 80 per cent loan-to-value ratio is a good guide for determining what the maximum amount is that you can borrow from the properties owned. The limitation will come when the growth of the business outstrips the funding capacity from these properties. What then?

4. Exploring debtor finance

Debtor finance is a form of cash flow finance that allows SMEs to use the value of their receivables as the collateral for obtaining credit. Whilst this is similar to the bank using a property as collateral for the overdraft, debtor finance differs in that as the sales of the business grow, so too does the value of the collateral (the invoices supporting the sales) and therefore there is no 'cap', as there is when property is the security.

Debtor finance refers to products such as factoring and invoice discounting, both of which are used extensively by SMEs in the mining services industry. The reasons are simple. The strong credit worthiness of the mining and natural resources companies is very attractive to a debtor financier because they are the ones who are ultimately settling up on the debt owed in a debtor finance transaction.

Debtor finance works whereby a financier provides an advance (up to 90 per cent) on invoices after there is some demonstration that the work has been completed for the invoices being financed. Then, on the invoice repayment date, the customer will pay the full amount of the invoice to the debtor financier instead of the SME. The financier calculates the fee generally associated with the length of time that the funds were outstanding and then a rebate from the remaining funds is returned to the SME for further working capital usage. Another advantage to debtor finance is that there is an inherent discipline to the credit as each invoice repayment retires the mini-loan as the repayment obligation shifts to the customers.

There are a range of debtor finance solutions available in the Australian market today, each with slightly different benefits depending on the nature of the small business using the service, the industry they operate in and their customers.

The key points of difference – besides price, of course – between the products are as follows:

- Some or all invoices – can you finance only selective invoices or does the finance company require you to put all of your invoices into the facility?
- Lock-in period – how long is the contractual term for the client to use the facility for? Some debtor finance companies have no lock-in period, whereas others have 24-month contractual terms with minimum fees. The average contract term is 12 months with a three-month notice period under a standard factoring arrangement. With a 'spot' factoring or 'selective' invoice discounting service, there is no lock-in period.
- Administration of accounts – standard factoring usually mandates that the debtor finance company will take over the handling of the Accounts Receivable function, which then allows them to send out statements, chase overdue invoices and pursue the customers when invoices are not paid on time. Other products allow the SME to retain control of the account administration function and only the invoices financed are then paid to the finance company.
- Disclosed or undisclosed – whilst there are some facilities that allow for the invoices to be factored or discounted without the customers knowing, this typically comes with the trade-off that all invoices must be part of the facility.

5. Don't use the ATO as your bank

The long payment terms in the mining sector also create a GST cash flow challenge for SMEs. Invoices issued in June will create a GST tax liability which will need to get paid to the ATO before the invoices are actually paid. This is one reason why as average payment days have increased, and so too have the requests for tax repayment arrangements.

In the past, SMEs were able to take advantage of the relative leniency of the ATO to repay tax liabilities over time whilst incurring interest at a relatively modest rate. This was due to the GFC, and then after the natural disasters of 2011 when the Federal Government wanted to show its support for small businesses.

This strategy worked well for a number of SMEs, particularly those who did not have access to other forms of finance (or perhaps were not aware of the alternatives), but this jig is now over. A quick review of the list of companies being wound up by creditors will show that the ATO is one of the most frequently mentioned entities that is using this process to have debts repaid.

If you have a repayment arrangement in place with the ATO, stick to it and meet your obligations. If you are behind on your BAS filings and/or tax payments, then speak with your accountant or tax agent about starting the dialogue with the ATO about entering into a tax repayment agreement. However, do not assume that one will be forthcoming – and definitely do not stick your head in the sand on tax issues because it is all too hard.

In summary, the boom in activity in the mining and natural resources sector will generate enormous company transforming and wealth creation opportunities for SMEs with competitive products and services to offer. But being ambitious and competitive in and of itself isn't enough – the SMEs that will benefit the most from the mining boom will be the ones that are also financially prepared to cope with the cash flow challenges of taking on such large-scale opportunities. mb