

Ups and Downs of Small Business

01/23/06

In reviewing my numbers for last year I noticed many swings in my sales. Some of that fluctuation was seasonal but some of it came out of nowhere. I decided to look back over previous years and saw great fluctuations between years as well. Is this normal? I know some years were tougher than others, but that seemed to be out of my control. Is there a way to predict great ups and downs or is it something I just have to live with?

This week's question comes from a software developer. The two owners, a senior and junior partner, take their business very seriously. They are committed to growing the business. One partner has 2 children in college; the other partner has 2 children in grade school. They both know that the success of their business will secure their children's education, and pay for their own retirements one day. Figuring out how to make the most out of the potential of their business, has real financial payoff for both of them.

Now, let's get back to their question about swings in sales. Let's take a look what peak and valley growth does to a business, and why you want to avoid it. Then I'll explain how businesses get into peak and valley growth. Next week, I'll talk about what you can do to achieve a more positive outcome.

Most privately held businesses do see peaks and valleys, some years up, some down. It's like the old saying, two steps forward, one step back. Unfortunately there is tremendous waste associated with this kind of growth pattern. Our reader, and anyone else who has seen similar trends in their business, have reason to be concerned about the ups and downs. They cost you a lot of money.

Sometimes the up and down trend in sales masks an even bigger problem, that the business has hit a growth wall. The business bounces up and down in a fixed sales bandwidth. It looks like some years are up and some are down, when in fact the business is just holding its own, not really making any significant growth progress.

What really happens to the business in up and down cycles? As many business owners know first hand, it is costly to scale back a business as revenues fall. Sliding down from a peak costs you, as the business uses up reserves, or takes on debt, to cover the cost of operating at the peak level, while margins slip due to loss of income. As business drops, you may have to let good people go. If you don't cut expenses fast enough, you use up savings to cover the shortfall between income and expenses. You pass on opportunities to expand, while your competitors pass you by. As you scale down,

you miss opportunities to serve clients, because you don't have enough resources to go around. You cannot afford to invest in cost savings opportunities, because you don't have enough money to go around. Sound familiar? That's the downward slope on an up and down growth curve.

Once you are on a downward slope, you have to turn things around. Driving the business up out of a valley uses up more resources. At the bottom of the valley, most likely your business operates at a low profit level, or even worse, at below break even. You have to use up savings, or take on debt, to make it through the slim profit margins, while you invest extra effort to build up sales momentum. Once sales start to pick up, you have to scale up your delivery, to meet the new demand. You probably have to play catch up with new technologies. You have to hire new people, get them trained, and figure out if they are a right fit for the business. It is like heating up a house, after the heat was turned down for awhile. It uses up a lot of energy, and energy costs money.

Why do businesses get into up and down cycles? One common problem is they either take on too little, or just as often, too much growth at one time. In our software developer's case, I happen to know that they actually started into their latest up and

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down cycle by taking on a 43% growth leap in one year. They took on more than they could handle, had to focus on digesting it, took their eye off the sales and marketing ball, and used most of their energy to hang onto what they had sold. That meant that the next year was down, and the year after that was flat. Now they are starting to dig their way out, but this type of growth has cost them a lot of profit, and used up reserves.

Other business owners live by the old adage of, getting by is good enough. They make some money for a couple of years, live off the reserves for the next couple of years while they coast. As reserves drop, they go out to find more business, and pick the business back up. They build up reserves again for a couple of years, and then it's back to coasting. They accept it as truth that the business was meant to operate with ups and downs.

Finally, there are business owners who accept what they hear. In bad market cycles, they hear things like: "it's a down year", "everybody is off", "there's nothing you can do about it". They wait for things to turn around. Or, they don't know what else to do, so they wait and hope that things will get better. In good market cycles, they hear things like, "things are picking up", "businesses are making more money this year", "the stock market is up", and they believe it,

and go with the flow. Unfortunately, the entire destiny of the business depends on what happens elsewhere in the marketplace. The business has no real ability to determine its own future. And so the owner learns to live with the ups and downs.

Just because most businesses tend to grow in an up and down pattern, doesn't make it right, or the best way to go. In fact, living with an up and down pattern wastes time, money and effort, and costs the business significant future potential. Next week we'll take a look at a more profitable growth theory, which we call the Optimum Growth Model.

Looking for a good book? Try, *Ahead of the Curve, A Common Sense Guide to Forecasting Business and Market Cycles*, by Joseph H. Ellis.

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