Ask Andi

Trusted Advisor to Business Owners

Lessons for big business

11/02/09

"You've talked about lessons small-business owners can learn from big businesses. I 'm reading a lot about mistakes the big guys made that resulted in the banking crisis. Can you talk about lessons banks and automakers could learn from the owners of privately held companies?"

Here are three large-business situations that illustrate the problems, not just of big businesses, but of all businesses that do not pay attention to long-term values.

Peter Drucker, management guru, in 1954 and again in 1999, defined profit as the ability to cover capital needs – a significantly greater test of profit than the traditional definition of covering operating costs. Using wealth creation as a definition of profit, Drucker stated that "few U.S. businesses have been profitable since World War II." He characterized firms that cannot form capital as wealth destroyers rather than wealth creators. In another situation, one CEO of a publicly held company said to a major New York newspaper, just before filing for bankruptcy in 2002, "I don't get up in the morning and crunch numbers." Finally, just before its collapse in 2001, Enron paid out $55 million in bonuses to key employees to keep them from leaving. Of course, while we know how that story ended, that amount now seems like small change when compared to the retention bonuses being paid out on Wall Street today.

Buck stops here

Take a look at these lessons of small business that some of our big-business counterparts might wish to consider. Owner-operators are the bank of last resort – the buck truly stops on the CEO's desk. Reserves need to be equal to, or greater than, the risks the company takes on. Reward employees based on what you can afford. Live within your means. Grow slowly, profitably, for the long term.

Few banks will lend to small businesses if the company does not have reserves and cannot demonstrate consistently profitable operation. It's also harder in small business to engage in creative accounting in order to make things look more profitable. Reporting in small business is much more straightforward and there are fewer places to hide losses.

Shortfall coverage lands squarely in the owner-operator's lap, either for signing personally on bank loans or for closing the gap when banks stop lending. While owners may not like having to loan back to the business, they are generally quite clear about their responsibility for making payroll and keeping the business going through tough times. I wonder how many Wall Street senior execs are willing to pull out a significant portion of their personal savings to keep their companies afloat.

Disciplined approach

Most business owners know they have to manage risks to keep the business safe. They may bulk up funds in advance, delay launching new initiatives, partner with other businesses or otherwise put in place contingency plans to keep the business safe. Successful owners understand that uncovered risk means potentially losing the business if things go wrong. And they recognize that it's foolish to kill the golden goose that has made money for them and all of the people they employ.

Every business owner can tell the story of an employee who came in demanding more in salary or bonus in order to stay. And every business owner deals with defining a line they cannot cross, called affordability. There comes a time when the business has to let an employee move on and put its efforts into finding new talent to sustain the business going forward.

Successful small-business owners are both owner and primary shareholder. That means the connection between profitable operation and distribution of profits is very tight. Most small-business owners' primary form of compensation comes from shareholder distributions, which is their reward for doing a good job running the business or penalty for making mistakes.

It’s impossible to make money out of thin air; just about every small-business owner knows that. Responsibly running the business includes understanding what drives revenue and profit, managing short-term needs against long-term plans and knowing when to take a calculated risk. Successful owners have a disciplined approach to growing and are not looking for a quick fix or bailout. They invest in learning what they need to know to ensure long-term success.

Looking for a good book? Try “A Colossal Failure of Common Sense, The Insider Story of the Collapse of Lehman Brothers,” by Lawrence G. McDonald.

Business owners regularly turn to Ask Andi and Strategy Leaders for advice on how to grow profitable, successful companies. They find what they need time after time. Specific advice is available at www.AskAndiBlog.com. Ask Andi is also published weekly in the Westchester and Fairfield County Business Journals and Hudson Valley Business. Written by Strategy Leaders President, Andi Gray, the Ask Andi column is a rich source of advice for owners of established, privately held businesses.

If you are a business owner and you have a question or would like to discuss some aspect of your business, call 1.877.238.3535 or send an email to AskAndi@StrategyLeaders.com.