

Issues and solutions for start up business: A true story of the trip to hell and back

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New Zealand Veterinary Pathology (NZVP) is an eight year old business that recorded one year of profitability in its first six years. At March 31 2010 the balance sheet had reached a nadir that fully supported the first stage of the journey outlined in the title.

Financial year 2009/10 result	\$139K
Shareholder deficit	\$499K
Liquidity ratio	60%
Financial year 2009/10 cash flow	\$156K
Cash balance	\$287K
Total debt	\$859K
Overdraft balance	\$294K

Table 1. Key Financial Measures at March 31 2010

It is my view that there were two fundamental issues that led to the company performing so poorly in its early years and arriving at this point.

Firstly the assumptions the business case was built on were overly optimistic. There are entire forests worth of books written on how to build a business case and how to forecast business performance. More immeasurable volumes are readily accessible via the internet. For all the theoretical models and recording of real case studies this area remains an inherently difficult combination of empirical measures and emotional aspirations.

In the case of NZVP the headline number that the cost structure was built around was the revenue projection of \$7.5M in the second year. The actual result was in fact \$2.4M. Clearly a \$5M or 68% discrepancy is going to lead to significant difficulties. The premise that the \$7.5M was built on was that the veterinary profession would flock to support the company on the basis of the New Zealand ownership. This core assumption was weighted too heavily towards the emotional aspirations element of building a business case and at best overshadowed what empirical measures were used. In a worst case scenario an unquestioning acceptance of the assumption did in fact lead to a scarcity of empirical work being done at set up.

Hindsight remains the clearest vision of all. The question then remains what can be done at the time of start up to avoid the hopes of the new enterprise being pinned on a forecast that later proves to be so far off the mark. I suggest the business plan should be subjected to impartial scrutiny. The views of people who are detached from the excitement of the venture should be enlisted to ensure the emotional involvement of the founders is balanced by an entirely cerebral analysis.

In addition to this some of the most basic properties of Microsoft Excel should be harnessed to view a range of scenarios. It is important in this exercise to correctly proportion costs between the categories of those that are

variable according to activity and those that are fixed. By adjusting revenue and cost lines by varying percentages the effect on the bottom line is easily viewed. The effect of varying percentage shortfalls in revenue provide very important warning signals that early revenue shortfalls should be considered against. On a more positive note there is a magical tipping point in this exercise at which the majority of further gains in revenue flow through to the profit. Knowing where this point is can be a very powerful motivation to grow the business.

The value of this exercise is to avoid the future of the business being pinned on a single scenario that due to the vagaries of forecasting may well prove to be far removed from the yet to emerge reality.

The second issue that I believe introduced difficulties concerns the structure of the organisation. Key positions were filled by people with existing and ongoing roles in the businesses of the shareholders. This meant they could not be as committed to NZVP as the company needed them to be in those early years. Leadership is vitally important throughout the life cycle of all enterprises, at start up it is crucial. Having a founding CEO who had a concurrent General Manager's role in an organisation where he was also a major shareholder was spreading the resource too thin in my view. NZVP needed someone to be living and breathing the company through those early stages.

Similarly the Palmerston North pathology resource was largely provided by employees of Massey University. They toiled hard and had a genuine desire to see NZVP survive and flourish. However they had to fit their diagnostic work around teaching and other university commitments. As a result clients experienced delays in turn around times that they were not used to and suffered terrible difficulties in being able to discuss their cases with the reporting pathologist. The veterinarians business was centred on providing the best service possible to their animal owning clients. By contrast NZVP staff were trying to fit the delivery of this important service around their other primary employment responsibilities.

Several other impediments loomed such as a reliance on old and unreliable equipment inherited from other shareholder ventures, a less than optimal headcount and a lack of marketing resources. These were the consequences of the poor performance caused by the more fundamental shortcomings as it meant there wasn't the ability to remedy them. While secondary in their origins they did in fact have a major negative impact on the quality of customer service. This resulted in a loss of customers which only added to the downward spiral.

So what were the paving stones for the road back from eternal damnation?

Shareholder backing

The inability to rectify the operational shortcomings around equipment, staff levels and the state of the facilities raise the question as to whether there was sufficient capital applied to the business. Once again hindsight would tell us we fell short in this area. The absence of any trading profits served to compound this as this meant the operational issues were unable to be addressed. Staff were always paid in full and on time. The same can certainly not be said about the creditors who endured several years of seeing the NZVP account firmly ensconced in the 90 days and beyond column of their receivables.

NZVP simply would not have survived without the patience and ability of the shareholders in continuing to commit capital to the business. In the case of Massey University this was done through the transfer of sums for services such as pathologist's time and rent from accounts payable to the balance sheet as loans. For others it was the injection of cash recorded within their current account balances.

External financing

The 2009/10 year saw a series of negative issues compound and drive NZVP to the position outlined in Table 1. This was at the height of Global Financial Crisis when many businesses were going to the wall and lending institutions were suffering heavy losses to bad debts. In this climate we had to ask for an enlarged credit line facility to meet our operational outgoings.

The backing of the shareholders played another important role in ensuring access to this lifeblood of external funds. Massey is legally prohibited from providing personal guarantees so it fell to the individuals Brian Linehan and Angus Black to put their names to paper. With that in place Medical Assurance Society (MAS) has gone on to become an incredibly important partner.

The existing credit line balance was transferred to a term loan and a significantly higher limit was applied to the newly opened replacement account. Naturally there was a great deal of very open and frank views expressed in

the negotiations required to achieve this result. Amongst these the single most important question we asked of MAS was for them to tell us what they needed from us in these shaky times.

Two things were stated as very important yardsticks we would be measured against. Firstly we had to communicate with them regularly. We agreed to supply our accounts at the end of each quarter but it was more than just the numbers that was required. They wanted to hear our views on the trends that were affecting us as well as on any variances from the planned results.

Secondly there was enormous emphasis placed on the need for our cash flow forecasts to be accurate. We were encouraged to request sufficient funds as any instance of us returning for more would be viewed very dimly as a signal we didn't understand our business well enough. NZVP was very well served in this aspect and the work of our Finance and Accounts Manager has come to be well respected within MAS.

Strategic foundations

While the early years were not kind to NZVP they did provide ample opportunities for learning. It is true that as I said earlier hindsight is the clearest vision of all but that doesn't preclude the necessity to actively look at and learn from what has gone before. I believe most business failures are preceded by more than enough warning signals that if heeded could have led to survival.

In the case of NZVP there were several lessons painfully learned that have served to build a much stronger business:

Set realistic goals

Almost as important as the return to profitability that the 2010/11 year produced was the accuracy of the result to what was budgeted for and planned on. Net profit was 5% above budget; Operating Income was 4.5% above budget. The main expense of staff costs ran in excess of \$2M. To see this come in at less than 102% of budget was very reassuring. These measures demonstrated that we had developed a good understanding of our business.

Live within your means

My experience in reporting to boards of directors has taught me there are some very easy targets they look to when assessing the level of management of expenses. The big three where management behaviour has a major impact are Marketing, Travel and Advertising. The 2010/11 accounts show a collective 21% saving when these expenses are measured against budget. Rather than the fabled use it or lose it mentality that is said to pervade the public sector this prudence has seen the NZVP board gain confidence in our forecasts of expenditure and even encourage us to consider whether an increased budget would be beneficial.

On a grander scale the board was presented with a cluster of major projects during the 2008/09 year. This was the first year the company was trading profitably and there was a lot of enthusiasm towards these projects that looked to address the lack of a Quality Assurance (QA) accreditation and perceived shortcomings in the Laboratory Information Management System (LIMS). The board's insistence that the allocation of funds to these projects was limited to half the budgeted profit for the year proved to be a very wise decision when NZVP struck rocky ground the following year.

Understand the drivers of your business

It took six years before NZVP achieved IANZ accreditation of its QA systems. It took less than six months following this for the comment to be made at the board table that the significance of this accreditation had not been realised early enough.

The months of December 2011 and January 2012 provide graphic examples of the truth of this observation. During these months the core work from diagnostic submissions from veterinary practices was virtually unchanged from the corresponding months one year earlier. At the same time the project work from clients requiring a laboratory to have IANZ accreditation increased more than tenfold to a figure in excess of \$300K. This transformed December and January from their traditional loss making status to profitable months with a combined increase in profitability over the previous year of just under \$200K.

Monitor the environment and your competitors – study yourself

The great sporting adage that one should only concern oneself with matters within your control deserves an even greater uptake by the business world than we have seen.

Too often I see evidence of a business that is fixated by what the competitors are doing. The vast majority of the management time and effort that is spent analysing the opposition would in my view be far more productively utilised spent focussed on one's own business. No matter how well you get to understand a competitor's business yours is the only one you can implement changes in. Spend your energy looking for positive changes you can make.

What is essential is a thorough and intimate understanding of the offerings of your own venture. When given the opportunity you should be fully conversant with all the benefits your business can bring to a potential client.

Of course you need to have a general understanding of your business environment and those operating within it. A more than sufficient understanding of these factors can be gained through conversations and reading in your breaks from work, leaving your entire working week committed to furthering your own cause.

Build a differentiated position

There are uncountable definitions of marketing beyond the accepted starting point of meeting customers' needs and wants. The one I subscribe to is that you should aim to achieve a position in the minds and hearts of potential customers that others will find difficult to match.

My comments above about the level of scrutiny to apply to understanding your competitors stand in relation to this objective. It is not difficult and does not take much time to learn what the key components of a competitive offering are.

Cost, customer service, range of services, client base and geographic spread are amongst the attributes a differentiated position can be built around. The challenge is to differentiate your business in a way that means something to your clients. The early assumption at NZVP that New Zealand ownership would be sufficient proved incorrect. Our following efforts to translate this into considering the wider interests of the New Zealand veterinary profession, agricultural sector and pet owners have provided the traction required. What is also paramount is that the position is not merely a framed set of words at reception. Clients have to be able to see your actions as delivering on the stated position. For us that has included the introduction of tests that are not economically viable on a stand alone basis.

With these foundations in place a start up venture is well equipped to set off on the great adventure that launching a new business is. Another group of issues then come into play that all have the potential to impact significantly either positively or negatively on the profitability.

Supplier relationships

NZVP has operated along the full continuum of these relationships. In our early days more than 90% of accounts payables resided in the 90 days and longer column. Clearly this made for strained relationships, removal of credit facilities and even refusal to supply.

As the business started to find its feet there was a deliberate strategy to form very strong alliances with key suppliers. These alliances were founded on a high degree of openness from NZVP. We shared a lot of detail about our business, supplier options we had and our views on our future directions. The development of the new relationships was not an instant result of us saying to a supplier that we wanted a deeper alliance. Coming from where we were it took several years of improved performance for us to gain the confidence of these partners and for them to see value.

Now we have a group of suppliers we go to when new technologies and markets present themselves and we are in a position to address them. As our partners see mutual benefit we invariably receive proposals that clearly cater for our preferences between purchasing and leasing equipment as well very favourable pricing and terms.

It is very important that a business does not limit its communications with suppliers to letting them know when something has gone wrong. We all have those clients that we know whenever we hear from them it will be because there is a problem. I like the analogy that a business relationship is like a bank account and that you need

to build up deposits of goodwill that will allow a positive balance to remain when a matter of contention brings about a withdrawal of goodwill.

Our relationships have the strength that has allowed us to request a review of pricing as our volumes have increased. However I have no doubt at all that NZVP has benefitted far more from long term agreements that include considerations of our interests than we would have from constantly demanding a better price for our day to day requirements.

An interesting aspect of these alliances is that neither NZVP nor our partners use the word exclusive. Such a characteristic is generally unrealistic, probably anti-competitive and quite frankly just doesn't make any sense.

Project management

As our business emerged from survival mode and began to grow there were several key projects that had to be commenced. Gaining accreditations, implementing a new Laboratory Information Management System (LIMS), bringing tests in house and renovating the Palmerston North laboratory are all major projects the company has embarked on in the past three years.

Having teetered so long on the edge it was alarming to then find how close we came to taking our new found momentum and using it derail ourselves. We made a grave error in taking on too many major projects at one time. The financial and human resources required for major projects are extensive and easily underestimated. We spread ourselves too thinly and impacted negatively on our core performance and placed key people under immense pressure.

Another lesson we learnt painfully was the importance of doing the early research and scoping of a project thoroughly. The need to change our LIMS was established on the basis of the benefits the new system could bring us. What was missed was an analysis of our existing system to see what untapped capabilities lay within it.

We experienced the almost inevitable cost and time overruns in the implementation of the replacement. When we finally went live our business ground to a halt and we inflicted an annoyingly high level of disruption on our clients. Only then did we return to the project management fundamentals and reassess our existing LIMS.

Today following a series of enhancements our existing LIMS, which we own, continues to provide us with a user friendly, flexible platform that was designed specifically for a veterinary diagnostic laboratory. We are even in early discussions with some parties on the prospect of the future commercialisation of Nulab.

IT

I certainly do not profess to have any expertise in this area and can not offer any advice on what the IT requirements of any start up operation are. However as our LIMS example shows IT is a crucial component for business continuity and we all know countless costly horror stories of organisations large and small getting it wrong.

This is an area to ensure you get good advice in. Don't accept the first advice without further scrutiny and proceed with care.

Cash flow management

NZVP got a very lucky break when we employed our current Finance and Accounts Manager. An immediate benefit came through the slashing of our external accountancy charges through her ability to prepare our monthly accounts.

Her ability to manage cash flow provided MAS with the comfort to stand by us when we so nearly went to the wall in 2009/10. During this time there was rarely a day I didn't ask her what our balance was. My message here is that as cash is the petrol for the engine of business you do not want to ever be surprised by an empty tank. It is possible to run close to empty for a protracted period of time but your fuel gauge must be accurate.

Managing account receivables is one of the most important aspects of cash flow management. NZVP is well served here with the veterinary profession as a client base. We have had to address a very small number of issues and our approach is a very considered one. We know what is like to find starting a business tougher than we first thought it would be. We bring a genuine empathy to all discussions we have had to have. We insist

on talking about the matter regularly, we let the client have input into the solution and we are flexible about what that solution looks like. Having been fair in the development of that solution we are then very firm in its implementation.

We have not lost a cent to bad debt and we have some very strong relationships with clients who have become our advocates on the basis of how we stood by them when they needed us to.

Revenue growth vs. cost reduction

As with NZVP, most start up businesses will strike rocky waters. If a business is fortunate enough for this not to be the case it will almost certainly generate opportunities to grow beyond the levels it is resourced for at start up.

Cost reductions are often the first response to either situation. It is my belief that such a primary focus will fail to deliver in both situations. Naturally every business should monitor and manage costs closely but I have no faith at all in a preoccupation in this area. The only sustainable solution to a weak financial position is to grow the income. It is a doubling of our revenue in the past four years that has seen NZVP recover strongly and not the reduction of any costs.

For NZVP this was about gaining new clients, introducing new tests and entering entirely new market segments such as export testing. The use of simple ratios is a very powerful tool to monitor the costs of any business while applying most effort to growing the top line. Viewing costs as a percentage of revenue will quickly highlight any adverse trends in the costs of your business.

If the subjects discussed to this point are described as the paving stones of our road back there is one overriding aspect of NZVP and every business that is tar seal that once applied turns that road into a motorway to success.

People

Today NZVP is a thriving and growing business and I have no hesitation in saying the most influential factor in bringing us to this point is our people. It is no coincidence at all that many of them have grabbed opportunities and can also be described as thriving and growing. The balanced scorecard approach to business analysis is a concept I have come to appreciate. I believe the state of our human resource is just as valuable and accurate reflection of our overall health as what is portrayed in our financial statements.

Our board sets the tone. The first and most stern challenge they had to the 2012/13 budget was that there wasn't enough allocated to staff development and salary growth. Salaries are only one measure of how people are valued. I have found the way board supported two of my colleagues who were confronted with serious illness as the most graphic examples of their commitment to people. It is true that such support could also be analysed in a monetary fashion but it was the more human aspects that were visible to all and that really served to build a culture where everyone knows they are seen as more than a number.

It is my view that my greatest responsibility to the board is to provide the leadership that allows a positive culture to develop. There is one and only one demand of me to do this and that is time. I can spend that time in many ways such as walking into the laboratories and seeing what is happening, sending weekly update emails or having individual conversations with people but it is all about me giving the time to do so. It is a real trap for a business at start up for the leaders to be so busy performing the tasks that lead to transactions and liaising with all the external parties that the rest of the people don't know where the business is headed. If you don't know, how can you be expected to care?

Communication is clearly the principal activity within the time I spend within NZVP. I have some strong views on how the nature of this communication should look.

It must be in plain English. Going forward is something I do in a car and while I have dealt with several issues I have yet to be across one. People are not impressed by how large a corporate vocabulary you have, they will judge you by the content of your messages. They need to be able to understand that content easily. There is a very healthy cynicism towards those who clutter their speech with jargon as it is often a way to mask that there is actually very little of substance being said.

It must be about the stuff that really matters. Our people know our financial position, they are told revenue and profit results each month and they know that debt repayment is a major priority. This is vital as it provides

the context for so many of the decisions that are made. Such open disclosure also helps to demonstrate the importance that is always placed on increasing their remuneration and benefits.

It must provide direction. Our values aren't framed and hanging in reception. Our goals aren't written on the lunch room whiteboards. They are talked about at staff meetings, used as examples in my weekly update emails and raised in many individual conversations. People at NZVP know what we stand for and what we are trying to achieve.

It must be consistent. Changing and conflicting messages are amongst the quickest ways to turn people off. If the message is seen as flavour of the month or what is best suited to a particular situation all credibility is gone. Why should anyone believe this message if they know it will have changed before long?

Perhaps the most powerful medium for communication involves no words, written or spoken. It is the actions and behaviours of the leaders of any business that people place the most credence on. People will not believe they are valued by being told they are it is how they are treated in every way that will form that opinion.

The complexities of people mean that all is not plain sailing in the realm of human resources. Some of the most positive influences within NZVP in recent times have come from facing up to and tackling the hard issues. Under performers and well poisoning staff are highly visible to all. Management that shies from addressing these individuals provide a multiplier effect to the damage. If colleagues see that there are no consequences to such behaviours they quickly come to feel that there is no point for them to strive to achieve for themselves and the business. Conversely it is a great motivator for everyone to see that there is enough conviction from management to face up to issues of under performance. I do not buy into the much quoted belief that it is very difficult to move people on that are holding a business back. It is certainly not pleasant but with due recognition of process and firm consistent management it can be achieved. It is important to attempt to remedy any situation at the outset. If this is clearly portrayed an individual will realise they are in the wrong place when the attempted remedy is not achieved.

I have become a strong advocate for linking performance to remuneration. Your business should adopt a formal review process that it is clear to all then feeds in to all decisions around salary increases. A blanket CPI (consumer price index) increase rewards non performers as well as your superstars. This is very good from the non performers' viewpoint and totally demoralising to the superstars who receive no recognition of their efforts.

The issues discussed are those I feel have made an important contribution to turning around the fortunes of NZVP. We now have a profitable business, our people are being paid more and have more development opportunities, and we are repaying debt and are able to consider proposals to grow the business. It has been a hard road but a very exciting ride.