**Great Southern**
**Development Commission**

# Impact of adverse seasonal conditions on the rural non-farm business sector

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GREAT SOUTHERN DEVELOPMENT COMMISSION

# Contents Page



# Graphs



This analysis of 12 local businesses took place amidst a background of four successive adverse seasons. For businesses in these and other similarly affected areas to survive, radical structural changes must be adopted, supported by government. This report does not claim to provide ultimate answers, and other views would be appreciated.

# 1. Summary Discussion

## 1.1 Background

The principal objective of this study was to identify the extent of the impact of adverse seasonal conditions on the rural non-farm small business sector in the Great Southern region of Western Australia. The study incorporated case studies of 12 businesses selected from the towns of Jerramungup, Pingrup, Nyabing, Gnowangerup and Ongerup. For the purposes of comparison, the businesses were drawn from the categories of retail, farm supplies and manufacturing.

The report presents evidence on the extent of increased competitive pressure on small business due to the reduction in market size, and the strategies employed to survive.

Three year Profit and Loss Statements and Balance Sheets were analysed, where possible. From this, standard questions were formulated to understand better the trends existing prior to the adverse seasonal conditions. This assisted in determining the extent of the farming downturn on small business profitability.

In addition to this analysis, comment is made on any indication of cost pressures passed onto the rural industry.

Assessments were also made of business confidence, and the interdependence of the business sector in the towns studied.

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The retail sector selected was food. All four businesses surveyed reported only moderate reduction in sales and gross profit margin.

Two of the six businesses surveyed in the farm supplies sector had dramatically increased sales due to the introduction of chemicals to their range of products. This created the illusion of growth, however further investigation identified reduction in sales of hardware and other farming supplies and a substantial drop in gross profit margin.

The worst hit sector was manufacturing and farm machinery sales. All four businesses reported their worst year on record. Sales in one business were down by 90 % on the previous year. All three manufacturing businesses admitted losing jobs where competitors had quoted below cost.
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The results clearly show that the businesses now operate in a more competitive environment than was the case prior to the adverse seasonal conditions. Businesses from outside the traditional market are expanding their geographical reach to chase sales in a greatly reduced market. External competitive pressure from the big players is filtering down and direct marketing is well and truly entrenched.

Common strategies to deal with reduced profitability were to reduce staff numbers and reduce levels of traditional stock. An equivalent of nine full time jobs had been lost in the 12 businesses surveyed. Stock levels were most affected in the farm supplies and retail sector. These strategies severely restricted the business' ability to maintain required service and to seek out marketing opportunities, as well as placing enormous personal strain on the people involved.

These businesses had been experiencing competitive pressure for a number of years but without exception, the pressure had increased significantly in the past two years. Major companies based outside the towns, have significantly intensified the competitive nature of the industry because of their own declining sales and pressure from their shareholders. It was the inability to compete on margin that really hurt small business.

The social cost of a struggling small business sector was enormous. Small business owners were feeling trapped and losing passion and commitment to their community. All of the business owners had increased the hours worked in the past 12 months. There appeared to be a high level of stress, both personal and business, and general dissatisfaction. Strong vision for the future direction of the business was less apparent. All businesses believed their fate lay in the hands of the farming sector.

As a result of the study, several obscure but important factors have arisen. One is the lack of financial base of the businesses to withstand adverse seasons. Four of the 12 businesses were in financial trouble almost immediately when the poor seasons started. Only three of the 12 businesses surveyed managed to increase their level of retained earnings over the past three years despite all business owners reducing their drawings. This indicated marginal profitability in rural business was prevalent even before the adverse seasonal conditions started.

However, there is no doubt the adverse seasonal conditions affecting farmers has had an enormous flow on effect to the local businesses.

The following recommendation pale into insignificance when compared with the massive short falls in the farming sector revenue, but they do indicate a way to prepare rural communities and businesses to be better prepared in the future to handle the seasonal nature of the farming industry.

A new business model is required for the future of non-farm small businesses and their relationship to small towns. This report suggests some long term strategies to add economic strength back to local communities.

However given the lack of retained earnings evidenced in this study in the non-farm business sector, immediate short term strategies are also required. This is to ensure basic business infrastructure is maintained during the current crisis.

## RECOMMENDATIONS FOR IMMEDIATE COMMONWEALTH GOVERNMENT ACTION

The Commonwealth government has programs in place that could be extended to the non-farm business sector in areas suffering from adverse seasonal conditions.

1 "Exceptional circumstances" assistance.

Interest rate subsides are available to farming businesses on pre-determined criteria. These criteria could be extended to the non-farm business sector and should include the level of retained earnings over 3 years.

2 New Enterprise Incentive Scheme.

This scheme pays the equivalent of unemployment benefit for 12 months to unemployed people who start up new businesses. It could be extended to deliver the same benefits through the same contacted service providers to businesses, based on criteria such as sales and net profit levels over 3 years

3 Community Development Employment Program

This scheme is available to Aboriginal people who are involved in community business projects before taking the next step into the mainstream workforce. Workers are paid the equivalent of unemployment benefits.

It is recommended that this scheme be made available to employers to assist in maintaining staff levels during the downturn.

4 Superannuation

To ensure retention of staff it is recommended that the Commonwealth pay the superannuation levy for businesses in the declared Exceptional Circumstances Area.

5 Financial Institutions

The Commonwealth could use its influence to waive any loadings over the base overdraft rate to encourage no penalty rates on accounts that exceed their limit.

6 Multi peril insurance

The State government has formed a taskforce to investigate the implementation of multi peril insurance. While targeted to the farm sector, multi peril insurance covering the cost of planting for the following year, gives farmers continuity which flows through to rural communities and small business. Hence it will give surety to the recovery from adverse seasons. It is recommended that the Commonwealth work with the State government in implementing the findings of the taskforce.

## STATE GOVERNMENT ACTION

1 Business Support Programs

The State Government has a range of programs to support local business through the Small Business Development Corporation (SBDC) and its Business Enterprise Centre Network.

These include:

- The Business Diagnostic services
- Specialist Enterprise development services
- Regional Smart Start Program
- Small Business Improvement Program
- Marketing Today Program
- Business Mentor Program

These programs, while available, are not generally known and require marketing. For example, the website is generic and makes no reference to the non-farm small business. In the early 1990s, RAFCOR did a good marketing job of their program during the wool crisis, using local newspapers such as the Wellstead Whisper, the Woodanilling Wongi.

It is recommended that targeted marketing to the non farm business sector be implemented by the Small Business Development Corporation.

2 Finance

While it is recognised the Commonwealth has a prime role in finance provision, there is an important auxiliary role for the State Government.

It is recommended that the State Government open negotiations with banks over relaxing criteria for security and financing of trading stock for small business. Paying for stock is the biggest expense incurred and is the largest cause of liquidity problems within the small business sector.

## STATE GOVERNMENT LONG TERM INITIATIVES

A CLEAR FINDING IN THIS REPORT WAS THE LACK OF BUSINESS AND MANAGEMENT SKILLS WITHIN THE BUSINESSES COMMUNITY IN DEALING WITH THE CURRENT DIFFICULTIES. WHILE THIS WAS RECOGNISED BY THE BUSINESS PEOPLE CONCERNED, LACK OF TIME, FINANCIAL PRESSURE, DISTANCE AND CONCERN OVER LOCAL TRAINING PROVIDERS, REAL OR IMAGINED, MEANT DEVELOPMENT OF THESE SKILLS WERE VIEWED AS A LOW PRIORITY.

An innovative approach is required to turn around the difficulties of the non farm small business sector. It is recommended that a new support structure be established to assist business in developing the necessary skills to trade out of their situation.

The GSDC, in conjunction with the region's light industry sector, has developed an eight month systematic mentoring program. The primary focus of this innovative model is to increase sales through better management and business acumen

The GSDC views such a scheme as an essential ingredient for interested businesses to develop broader marketing strategies, such as cluster development, joint tendering for larger projects and expansions.

In the case of non-farm businesses, such a program could lead to long term sustainability, cooperative models for doing business and equity partnerships with key suppliers and other potential partners such as the "new Telco's" to stem capital outflows.

# 2. Background

## 2.1 Project Brief

The seasonal conditions of the past two years have impacted greatly on farmers throughout significant areas of the Great Southern region. Given the importance of rural non-farm small business, and the range of factors that will determine its longer-term viability, the Great Southern Development Commission assessed that the sector should be consulted in depth.

"Small business" was defined as:

- Any business that is independently owned and operated personally by the major investor(s), maintains a relatively small share of the market and does not form part of a larger group.
- A non-manufacturing business employing less than 20 persons or manufacturing business employing less than 100 persons.

The Project Brief also recognised that many small businesses may be experiencing financial hardship either as a direct result of seasonal conditions, or other factors. This context was addressed in the study, in particular through documentation of cost pressures and any subsequent price increase to customers.

The project consisted of 12 case studies of businesses selected from the towns of Jerramungup, Ongerup, Pingrup, Nyabing and Gnowangerup. Each business was asked to provide financial information for the past three years so that financial trends could be established. To determine the effect of the adverse seasonal conditions, a series of questions was asked to determine each business' reaction to their current circumstances and their strategies for the future.

## 2.2 Study Objectives

The purpose of the study was to collect information on the economic environment in which rural non-farm small businesses currently operate, and how they have adjusted to that environment.

This was achieved by:

1. Analysing profit and loss statement over the last three to five years.

2. Assessing future confidence, including expectations of remaining in business over the next 18 months, debt levels, credit position and employee levels over the same period.

3. Assessing the interdependence of the business sector by seeking information from respondents on other businesses in town and the impact of business closures on the retail sector.

4. Identifying, where possible, other major issues for consideration.

## 2.3 Case Study Methodology

Twelve businesses were identified in the selected towns on the basis of (a) being an integral part of the economic community, and (b) affected by the adverse seasonal conditions.

Each business proprietor was personally interviewed to ascertain:

1. A financial analysis of the past three years, and 2001 forecast, for key areas such as:
   - Sales
   - Gross Profit
   - Key Overheads
   - Net profit
   - Stock Levels
   - Staff Levels
   - Hours worked by owners
   - Balance sheet summary
   - Net equity

   *Outcome:* Identification of the connection between non-farm business performance and farming performance and the effect that other factors such as competition, reduced margins and cash flow had in various seasons.

2. Assessment of business objectives for the next 18 months, and expected changes in:
   - Sales
   - Gross Profit Margins
   - Net Profit
   - Stock Level
   - Capital Requirements
   - Technology Usage and Development
   - Management Skills
   - Working Capital and Financing

   *Outcome:* Assessment of the probability of the business being able to achieve its objectives.

3. An assessment of human resource issues.
   - Success ratio in filling vacant positions
   - Laying off people due to lack of work
   - Staffing or employment changes over the next 18 months
   - Effects on business objectives.

   *Outcome:* Determination of the required skill level and personnel readily available to achieve the objectives of the business.

4. An assessment of the debt repayment program.
   - Possible increase in payments over the next 18 months
   - Identification of banking sector changes, including penalty interest rates, fees and valuations of business assets.

   *Outcome:* Identification of major trends and attitudes relating to debt levels, including the effects of debt levels on business performance and whether development was impeded due to the level of confidence.

# 3. Analysis Results

## 3.1 Financial Analysis

### 3.1.1 ERROR! UNKNOWN SWITCH ARGUMENT.SALES

The sales results over the three sectors were very different. The retail sector (food) remained relatively unchanged with a 5% increase in sales over the three years ending June 2000. This however was overshadowed by expectations for the year ending 30th June 2001. Of the businesses that had interim figures, all had forecast at least 20% decline over the previous year.

The farm supply sales results were mixed. Of the four businesses surveyed two increased sales by at least 60% over the three years and two reduced sales by at least 20% over the same period. It all related to product mix. All four businesses experienced sharp reductions in sales in the "fringe industries" such as fencing, hardware and animal products. The reduction in sales of these products was gradual over the past three years in the eastern districts and more sudden in the Gnowangerup and Ongerup regions. This was particularly so in the businesses directly associated with farming enterprises.

This pattern forced two businesses to add low margin products to their range and enter into direct farm supplies with, for example, chemicals. This resulted in sales increasing overall, which allowed them to remain in contact with the farming sector with the hope of retaining higher margin sales of their core " fringe " products.

One business cited the marketing practice of a large rural merchandising company using chemicals as a loss leader to provide opportunities to use refined sales and marketing techniques in attracting the higher margin sales. The company concerned may in fact have been building its sales in an effort to make itself more attractive to potential purchasers, and was consequently taken over. According to two of the businesses surveyed the damage left behind in terms of profitability and cashflow contributed to them requiring additional finance to operate their business.

The manufacturing sector was worst hit with a reduction in average sales of 40% to the year ended 30th June 2000. This sector was also the largest employer with the three businesses employing seventeen people.

One manufacturing business had a 90% reduction in turnover. Remaining jobs were undertaken at cost, or less, just to keep staff on. To counteract this reduction, the business was forced to find sales in other markets, which had a negative flow-on effect to other businesses. The recent closure of Sherwells in Katanning highlights the impact of the seasonal conditions on this sector.

The overall result of this trend was that over the past three years businesses in rural towns seem to have become more inter-competitive, increasing their range of products and services in non traditional markets. Businesses in the retail sector are providing farm supplies, businesses in the manufacturing sector are entering into farm consumables and the farm supplies sector has increased its chemicals sales to nearly 80% of total sales. Whilst this has some advantages to the farming sector, it is not sustainable. It puts enormous financial pressure on the business sector due to bigger inventories, increased levels of debt and the requirement for more product training. The danger is that whilst one business may ultimately survive, the businesses remaining will find it difficult to compete on the broader market. Hence, the community will suffer because the remaining business may be financially unable to provide an acceptable level of products and services.

As an example, in one town, two businesses survived reasonably well competing in separate markets. The past two years saw considerable expansion of products from both businesses, to the point where they were direct competitors. An interesting observation was that one farmer felt uneasy about the obvious conflict between the two businesses because it was forcing customers to choose between the two – something that is unhealthy for any town.

There was mixed reaction concerning local support. Whilst some businesses felt there was reasonable local support, others felt their clients purchased goods out of town and paid cash. However, when it came to an emergency or they had a poor cash position, they bought locally on credit and were slow to pay.

The adverse seasons did increase opportunities for some businesses in, for example, repair work as opposed to low margin new equipment, and dry season opportunities such as dam cleaning. However, this additional work was expected to be one-off and not have a large impact long term if the conditions prevailed.

Some businesses had the capacity to move from new sales to repairs and maintenance quite easily. One business had a dry season opportunity present itself so they could maintain a cash flow through the adverse conditions.

### 3.1.2 ERROR! UNKNOWN SWITCH ARGUMENT.**GROSS MARGIN AND STOCK LEVELS**

Whilst sales in the each business sector varied, the gross margins were severely reduced. The retail sector average gross margin dropped by nearly 20% in the three years ending 30th June 2000. Farm supply margins dropped by 23% and manufacturing by 44% over the same period.

Reasons given include:

- Increased competition between local businesses
- Increased external competition from regional and capital cities
- Pressure on the farming sector to source cheaper prices
- Financial pressure forcing a product focused market
- Improved communication and ease of travel

There was a common view that local business must offer the essential farm supplies to farmers to attract them into their premises. Once farmers buy their larger farm requirements elsewhere, the expenditure on the higher margin items reduces. Whilst this claim is valid, the business proprietors needed to be better educated on the effects on cost structures of doing high volume business with little or no margin. Most businesses in the study took on the financing and payment risk of these large outlays. Several businesses required only a 5-10% bad debt factor to put their businesses at great risk.

One business sold nearly $500,000 worth of chemicals last season yet the return on this outlay was less than $20,000. Any one contract that was unable to pay would have resulted in disaster for the business.

There was a definite trend to smaller, more frequent purchases by the farming sector, which led to uncertainty in the business sector regarding stock levels. The ordering process had become more *ad hoc*, resulting in a corresponding reduction in purchasing power, an increase in administration costs and expensive overnight freight.

Competition and reduced profitability also forced businesses to reduce traditional stock levels, especially the range of higher margin products carried to generate personal income. These were replaced by low margin, high volume farm products such as chemicals. This reduced the level of product specialisation of rural businesses, as they tend to only stock the more popular brands, again increasing the level of competition by reducing choice.

In many instances, this positively impacted on the business' cash flow but left it exposed and vulnerable to competition as it reduced the availability of items. This will require a substantial non-tax effective expenditure to rebuild stock levels to an acceptable level. These stock levels, in many cases, were built up over many years and it will require a lot of confidence in the small business sector to rebuild them.

Consignment used to be a popular option for financing stock levels. Due to cash flow pressures from suppliers, three retail and farm supply businesses commented that they were finding it increasing difficult to access this source. In fact, one business was told unequivocally that all consignment stock in its possession was to be purchased. There was to be a no-return policy and the business had to pay over $20,000 for this stock. This prevented the business from taking advantage of buying early stock for next season due to cash flow pressures. Low stock levels made the shops appear empty and left the impression that major centres have better ranges and choice.

### 3.1.3 Cost Pressures

There was no evidence of the businesses passing on cost pressures to their customers. In fact, the opposite was true, compounded by a lack of purchasing power. This was supported by the reduction in gross profit and net profit percentages as shown in figure 3.1.2. The pressure from the consumer was so strong that businesses were absorbing margin reduction in order to retain traditional markets. Trends in purchasing patterns and risk factors were not allowing the small supplier to purchase in bulk to improve on these margins. The suppliers were all saying that the prices were the best they could do, but stories were told of competitors selling products for less than cost and using refined selling techniques, which were difficult to combat.

The manufacturing sector was unable to compete on costs with larger companies with access to vastly cheaper components, for reasons ranging from access to better technology in machinery to cheaper sources of imports.

One business manager was amazed at the comments from his customers that he was considerably more expensive than his larger opposition when he knew he was only adding less than 5% margin.

It appears the businesses had no time, energy or skill to negotiate better deals. Because of this, personal stress caused them to accept the status quo rather than stepping back and applying creativity to the issues. This includes creativity in marketing, key relationship management, shop and stock presentation, promotions and sales techniques.

### 3.1.4 ERROR! UNKNOWN SWITCH ARGUMENT.**STAFF LEVELS**

Reducing staff numbers was the common response in dealing with profitability pressures. Of the 12 businesses surveyed nine full time jobs had been lost in the past three years. Almost all businesses laid off staff over the past two years, to a point where they admitted it was costing them customers and profit.

The retail sector accounted for the largest reduction in numbers, and the farm supply sector employed the least number. The largest employer by far was the manufacturing sector, which accounted for 45% of the employees. This is also the sector that had the largest reduction in sales in the year ending 30th June 2000, which indicates a serious issue.

The impact of the overall reduction in employees was that it forced the owners to spend more time in their business and less time building relationships and seeking opportunities. In some cases, a business partner worked externally so that a staff member could retain their full-time job. In almost all cases, the hours worked by owners had increased to counteract staff reduction.

All business sectors were concerned about the loss of employee skills should the lost staff leave the district or find employment elsewhere. This was especially relevant in the manufacturing sector where experienced trades people often left the district when the work ceased. It is possible that this sector has held onto the employees longer than economics would dictate for this very reason.

In one business, the business partner was forced to work part-time in order to supplement the family income so that an experienced full-time worker, who had indicated the need to seek an alternative full-time job if the hours were reduced, could be kept on.

Three owners were forced to consider selling their business in a depressed time and at the risk of losing substantial personal capital due to the pressure they were working under. Of the four businesses that had changed hands over the past three years, not one owner believed he made the right decision to buy the business.

In the nine businesses that employed staff, morale was generally low due to the low level of optimism of the owners and the pressure they were under. Two manufacturing businesses had stopped overtime and staff members were in constant fear of losing their jobs.

In one instance, a business sent the entire staff to a sister business in Perth for two months in an attempt to keep them employed until the local economy improved. The local situation has not improved and staff were expected to be made redundant shortly.

### 3.1.5 ERROR! UNKNOWN SWITCH ARGUMENT.**OVERHEADS**

The overheads as a percentage of sales rose by 7% over the three years. The sharp increase in the year ending 30th June 2000 indicates that the businesses retained their business infrastructure throughout the year and were unable to react quickly due to the seasonal nature of their business. By the time the extent of the poor season had been recognised it was already eleven months into the financial year.

Freight, repairs, telephone costs, fuel and travel continue to disadvantage rural businesses in this day of fast travel and communication. All business sectors felt they were unfairly positioned in these key overheads. One business in the manufacturing sector was disappointed that it took four years to provide sufficient power to run his machines yet he still incurs one thousand dollars per month to provide diesel for his own generator.

Businesses under financial pressure naturally review their overheads. " Easy " targets include advertising, insurance, repairs, and education and training. Two business owners had increased their personal risk by minimising both business and personal insurance premiums.

Education and training were still viewed as an expense rather than an opportunity, evidenced by a lack of appreciation of the value or need for management and staff training. This was compounded by the lack of quality modern business training provided by local institutions. No business owner was currently undertaking any management training. Employee training was restricted to industry requirements and Government regulations and requirements. As a general summary, the survey participants viewed training as being delivered by people with no experience in small business as well as being too theoretical and irrelevant to their needs.
Some of the newer marketing concepts were not even alluded to by the survey participants, despite the fact that some had attended so-called "modern" seminars. All businesses recognised the need for training but, due to other pressures, failed to take the necessary action.

### 3.1.6 BALANCE SHEET ANALYSIS AND RETAINED EARNINGS

It was not possible to ascertain exact profits and debt levels as five businesses did not wish to fully disclose their financial situation and preferred to talk in generalities. Hence where possible we have referred to hard data but in some cases anecdotal evidence is used.

Only three of the 12 businesses surveyed increased their level of retained earnings over the past three years despite all business owners reducing their drawings. In one of these three businesses the owner had not drawn a salary for three years, but relied on his investment income to provide his living. This indicated that marginal profitability in rural business was prevalent even before the adverse seasonal conditions started.

One of the key aspects observed among survey respondents was the lack of appreciation of asset management and asset utilisation.

The financial statements of the vast majority of those surveyed showed no analysis of balance sheet item movements. There was a steady decline in the "balance sheet health" of all the businesses surveyed and this decline was masked by the assumption that all the items were valued at current values. In all cases, no allowance was made for revaluation of assets, given the unrealistic view of the health of the business.

Accounting and taxation standards do not reflect the true position of a business regarding movements in valuation of balance sheet items. Examples of this include historical costs of land and buildings, depreciation of old and obsolete stock and devaluation of plant and equipment.

Due to the compliance focus of accountants, often the profession no longer has the time or skills to develop the business owner's financial acumen and has even less appreciation of his complete business affairs.

### 3.1.7 CASH FLOW

In relation to liquidity, only one business had adequate business working capital facilities in place to be able to pay all creditors on time. All other businesses had, to various degrees, relied on extending the credit terms of their suppliers and some juggling of payments. The level of working capital overdraft and fixed term debt for each business depended on the financial position of the owners and could not be determined by business sector.

Business overdrafts are designed to assist businesses manage short-term cash flow fluctuations. Six businesses that were not in a strong financial position found that the working capital requirement was very tight, to the point where pre-existing overdraft facilities had been fully used and were now technically core debt. Three businesses had successfully sought refinancing options in the past 12 months. This tight cashflow pressure was usually a strong indicator of financial decline, as it affected margins due to the inability to take advantage of early settlement discounts.
In the retail and farm supply sectors large amounts of money were tied up in stock and debts. Small businesses in these sectors were unable to use stock as security for further finance even though the business may have had several hundred thousand dollars in stock.

Cashflow was also dramatically affecting relationships with suppliers and customers. All of the businesses felt that the suppliers had become harder regarding their own credit terms and, in some cases, offered cash only terms after seven days. Due to lack of working capital, the only solution was to increase the credit term of the non-essential suppliers, mostly local or regional support businesses. This had a flow on effect to the region because the city businesses were being paid in cash causing the regional business to carry a larger portion of debt.

In relation to customers, one business owner reported that a local farmer was instructed by his bank to delay all payments to local businesses as long as possible. Payment terms for the customers had in most instances increased and took much time and effort to collect. The businesses were also very sympathetic towards the plight of their customers and felt uneasy about collection of monies owed. As one business owner said, "The farmers have not stopped spending – they have just stopped paying".

In most cases, there appeared to be little appreciation of the management of factors influencing cash flow. There were triggers indicating current and future cash flow problems, such as juggling payments and working capital ratios, that would have addressed these issues if recognised. To some extent, the GST reporting requirements have improved the financial awareness of business owners due to their timeliness and relevance. Business profitability and cashflow trends are more easily identified on a monthly or quarterly basis, rather than annually.

## 3.2 Assessment of Business Confidence

### 3.2.1 Business Factors

With declining profitability and cash flow restrictions, all the businesses surveyed were concerned about what business infrastructure changes would need to be made to ensure their success. These changes included range of products offered, staff numbers, customer base and in two manufacturing cases, location. All business sectors surveyed expected a tightening of their financial position during the next six months. They were concerned that another poor season would impact on their ability to survive into the next year. Four businesses indicated they would have to try to sell if things did not improve within the next six months. In fact, two others who had relocated from Perth within the past four years indicated they were seriously thinking about returning to Perth. These business owners, who still have business ties in Perth, were surprised at the degree of difficulty of operating a business in the country. The key unanticipated areas were lack of volume, access to markets, cost of services, cost of freight, and lack of skilled trades people.

Three businesses felt they would receive a much better level of service from the various levels of government in setting up infrastructure if they were in the city.

Obviously, established businesses with little or no debt were better equipped to handle the adverse and seasonal conditions associated with most rural communities. The retail and farm supply sector carried the most debt in line with the requirement to fund larger stock. Knee jerk reactions in response to handling these conditions ranged from wanting to close the door, to staff reductions and selling down of stock.

Half of the business people surveyed had various degrees of lack of confidence in the banking system and in approaching banks for further finance. In two cases, refused finance and fear of inadequacy as a business owner prevented financial relationships from being formed. Not only did owners fear rejection, they were no longer confident of receiving assistance if this was required.

Six of the 12 businesses surveyed felt they would be unlikely to gain access to further finance if this was necessary to carry through another year.

It was apparent that all the small business owners needed further funding for the business to develop. Further funding would be used to develop product range, fund staff in administration and sales, and restore and repair premises. This was evidenced by five of the 12 businesses operating in premises that would not be allowed in major regional centres or the capital city. This added to the perception that rural businesses are in decline and do not have the range or price competitiveness of the larger centres.

The remaining business owners were not adverse to spending money renovating premises, but were reluctant to do so as there was no financial capital gain achievable. An example was a manufacturing plant which originally cost nearly $ 400,000 now valued at $ 200,000 by the owners. No capital gain, the current rural economy and high infrastructure costs had all but halted commercial and retail development in most of the surveyed towns.

There was a great disparity between the business owners' knowledge and awareness of their financial status. Five of the businesses produced some form of regular management reports but of the financial reports studied, only one had a five year trend analysis, and not one had a detailed funds flow report to determine where the cash generated was being spent. It is apparent that traditional accounting approaches, so common in addressing business issues, have not worked.

Increasing compliance and competitive pressures are impacting on small business managers who are unable to cope with the workload. Multi-skilling in the management environment has become the biggest issue along with the need for more efficient and effective tools, including customer database management, project management, access to information and systems and procedures.

The level of compliance within the sectors appeared generally good. The backlash against the GST was not so much over the concept but the additional workload placed on the business owner, or the perception of additional workload. However, there was a general feeling that some rules and regulations are so extensive that many business operators ceased to care whether they complied or not.

### 3.2.2 PERSONAL FACTORS

Personal factors were  significant in whether or not businesses will continue. The underlying context of the businesses being in a farming region, and subject to some seasonal fluctuations, produced high levels of personal and business stress, and dissatisfaction with current directions.  Strong visions for the future were not apparent.  In many cases, it appeared the owners felt trapped and had lost some passion and commitment to their community.

An example of this was one business owner who, after working 70 to 80 hours per week, relied on his wife working three nights per week 50 kilometres away to provide household income.  This had even greater consequence when it was realised they had two young children.  Two years ago they had a dream of buying what they thought was a solid business in a safe area and becoming involved in a rural community and the lifestyle opportunities it presented.  They now believe they are seriously at risk of losing all their savings.

Only four of the 12 businesses had a clear succession plan with some formal mechanisms for transfer. The general hope was that the business survived until the good times returned and then the business would be sold. Six of the businesses indicated they would sell immediately if they could recoup their capital.

Regardless of Government support or other assistance that may be available, it appears that the sustainability of these rural towns is an issue for the community.  The whole community needs to consider what services and products they wish to have locally.  This will require strong visioning and leadership skills to evaluate "the community's best interest" as opposed to the individual's best interest.

It was highly evident that business owners were so involved with survival that they had little time and showed a negative attitude towards supporting community affairs, so vital in building vibrant communities.

### 3.2.3 INTERDEPENDENCE OF THE BUSINESS SECTOR

There is no doubt that due to the tough times, the retail and farm supply sectors had expanded their range of products to become closer competitors than before. This provided much needed sales and profit, but at the expense of margin. It was not always clear whether it was a strategically planned move or a knee jerk reaction to the adverse conditions.  In both cases it was the business in the weaker financial position that took the first move, indicating a knee-jerk reaction. If this situation prevails, then one business will ultimately survive but will have depleted financial reserves to withstand future difficult years.

The competitive market was also external. Big rural merchandising companies had always provided a safety net for consumers checking around for lowest prices. However three farm supply businesses commented on the increase in price competition from one such company during the past two years.  In fact, the company concerned was accused by one competitor of using farm chemicals as a loss leader in order to access markets for high margin general hardware and farm supplies. It appears this strategy may have been to increase the company's value in its subsequent merger, as recent feedback indicates some improvement in margins. This was unfortunate timing, coinciding with the adverse conditions, and impacted on the three farm supply business' financial ability to survive.

The two businesses that did improve in the adverse conditions had two common elements. They were part of a good buying group, which gave favourable payment terms and competitive prices. Being part of a group instils accountability, product training, planning support and staff training. Some groups are obviously better than others.

The second factor was control of and access to adequate finance. Both businesses had either another source of income or adequate cash reserves. The four businesses operating on the edge of their facilities were unable to take advantage of cheap prices, had a poor reputation for paying, and were seen as contributing to other businesses misfortune by not paying within the terms of trade. These were the first to let staff go, the first to start selling other products and the first to start reducing core stock.

A business closure in the retail and farm supply sectors is generally taken up by another business in the town. However, closure of a manufacturing business is a different story, especially if the business has a substantial number of employees or is a convenience for the farming sector. If the farmers cannot obtain what they need locally, they look to other towns for services. One manufacturing business employed six people with a turnover in excess of two million dollars. The turnover for 2001 was estimated at $200,000 and four of the employees were seconded to a Perth business just to keep them on the payroll. This business was one of two manufacturing businesses seriously considering its location options. The other business employed 12 people and suffered a 30% reduction in sales and gross profit.

The major concern about moving back to Perth is the capital loss that would be incurred selling the premises. The businesses expect to recover only 50% of the capital outlay without considering the repurchase price into the Perth market. This emphasises one of the biggest barriers to rural development, lack of capital appreciation of assets.

# 4. Conclusion and Policy Implications

The main thrust of this study was to identify the impact of adverse seasonal conditions on the rural non-farm business sector. While the brief was quite specific in its individual business perspective, the research needed to be considered in a wider context, primarily the broader issues affecting small business in rural towns.

The extent of adverse seasonal conditions on the small business sector needed to be considered alongside the general issues that affect the same sector, ie was it a case of a couple of bad years or was it the final nail in the already built coffin?

These businesses had been experiencing competitive pressure for a number of years but without exception this had increased significantly over the past two years. There was both local pressure from businesses expanding their market presence into other sectors, and external pressure from the major players seeking to address declining sales and shareholder pressure on performance.

The social cost of a struggling small business sector is enormous. Small business owners were feeling trapped in their business and losing passion and commitment to their community. There was a greater level of stress, both personal and business, and dissatisfaction in where their lives were heading. Strong visions for the future were not apparent.

## 4.1 Policy Implications

There is no doubt that businesses in all sectors were directly affected by the adverse seasonal conditions in terms of reduced profitability and staff numbers. The reduction in the size of the market and the cost of retaining a serviceable business infrastructure were just too high.

Farmers stopped spending on indirect farming inputs. What expenditure remained was fiercely competitive, leaving local businesses with the little left over. Unfortunately, due to a range of factors, this has put at least three of the businesses in serious doubt and in fact three others may only survive as a result of others stopping trading. The effect will further compound the rural towns' problems with potentially a further three families leaving the district.

The three businesses supplying farming essentials were affected by the agendas of others, with a negative impact on profitability. For various reasons, these businesses were unable to compete on price and relied heavily on local support. The reduction in profitability forced many to retract in a period where they needed to increase their level of stock and service. It has become a downward spiral that is unsustainable and could result in more business closures.

There is nothing to indicate that this has not happened before and will not happen again. The difference is that significant areas of the agricultural district are experiencing their fourth year of adverse seasonal conditions and this year, according to the government's Exceptional Circumstances Interagency Committee, some 2000-3000 farmers are seriously affected.

Hence a new business model is required for the future of non-farm businesses and their relationship to small towns. This report suggests some long term strategies to put economic strength back into local communities.

However, given the lack of retained earnings evidenced in this study, immediate short term strategies are required to ensure that basic business infrastructure is maintained during the current crisis.

## RECOMMENDATIONS FOR IMMEDIATE COMMONWEALTH GOVERNMENT ACTION

The Commonwealth government has programs in place that could be extended to support the non-farm rural business sector in areas suffering from adverse seasonal conditions.

1 Exceptional circumstances.

Interest rate subsides are available to farming businesses on pre-determined criteria. These criteria could be extended to the non-farm business sector and should include the level of retained earnings over 3 years. For individual businesses the assessment of eligibility could be undertaken by the State Government's enterprise development services through its Small Business Development Corporation.

2 New Enterprise Incentive Scheme.

This scheme pays the equivalent of unemployment benefit for 12 months to unemployed people who start up new businesses. It is delivered on contract through the government's Job Network program. NEIS could be extended to deliver the same benefits through the same contracted service providers to businesses, based on criteria such as sales and net profit levels over 3 years.

3 Community Development Employment Program

This scheme is available to Aboriginal people involved in community business projects before taking the next step into the mainstream workforce. Workers are paid the equivalent of unemployment benefits.

It is recommended that this scheme be available to employers to assist in maintaining staff levels. It would be equivalent to a wage subsidy to ensure skilled workers are maintained during the downturn.

4 Superannuation

To ensure retention of staff it is recommended that the Commonwealth pay the superannuation levy for businesses in the declared Exceptional Circumstances area.

5 Financial Institutions

It is recommended that the Commonwealth use its influence to waive any loadings over the base rate, to encourage no penalty rates to accounts that exceed their limit.

6 Multi peril insurance

The State government has formed a taskforce to investigate the implementation of multi peril insurance. While targeted to the farm sector, multi peril insurance covering the cost of planting for the following year, gives farmers continuity which flows through to rural communities and small business. Hence it will give surety to the recovery from adverse seasons. It is recommended that the Commonwealth work with the State government in implementing the findings of the taskforce.

## STATE GOVERNMENT ACTION

1 Business Support Programs

The State Government has a range of programs to support local business through the Small Business Development Corporation (SBDC) and its Business Enterprise Centre Network.

These include:

- The Business Diagnostic services
- Specialist Enterprise development services
- Regional Smart Start Program
- Small Business Improvement Program
- Marketing Today Program
- Business Mentor Program

These programs, while available, are not generally known and require marketing. For example, the website is generic and makes no reference to the non-farm small business. In the early 1990s, RAFCOR did a good marketing job of their program during the wool crisis, using local newspapers such as the Wellstead Whisper, the Woodanilling Wongi.

It is recommended that targeted marketing to the non farm business sector be implemented by the Small Business Development Corporation.

2 Finance

While it is recognised the Commonwealth has a prime role in finance provision, there is an important auxiliary role for the State Government.

It is recommended that the State Government open negotiations with banks over relaxing criteria for security and financing of trading stock for small business. Paying for stock is the biggest expense incurred and is the largest cause of liquidity problems within the small business sector.

## State Government Long Term Initiatives

A clear finding in this Report was the lack of business and management skills within the businesses community in dealing with the current difficulties. While this was recognised by the business people concerned, lack of time, financial pressure, distance and concern over local training providers, real or imagined, meant development of these skills were viewed as a low priority.

An innovative approach is required to turn around the difficulties of the non farm small business sector. It is recommended that a new support structure be established to assist business in developing the necessary skills to trade out of their situation.

The GSDC, in conjunction with the region's light industry sector, has developed an eight month systematic mentoring program. The primary focus of this innovative model is to increase sales through better management and business acumen

The GSDC views such a scheme as an essential ingredient for interested businesses to develop broader marketing strategies, such as cluster development, joint tendering for larger projects and expansions.

In the case of non-farm businesses, such a program could lead to long term sustainability, cooperative models for doing business and equity partnerships with key suppliers and other potential partners such as the "new Telco's" to stem capital outflows.

# Stakeholders Contacted

DEPARTMENT OF AGRICULTURE

Great Southern Development Commission

Central Great Southern and Jerramungup Business Enterprise Centres

Shire President – Gnowangerup

Chief Executive Officers, Gnowangerup, Jerramungup and Kent Shires

Selection of business banking managers at Albany and Katanning