SMALL BUSINESS ASSIST

Financial Management Workbook

Manage your business finances better.

BUSINESS TAKES VISA | SCORE® Counselors to America's Small Business

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INTRODUCTION

- Welcome
- What is Cash Flow?
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Welcome to Financial Management for Small Business

EVERY BUSINESS DECISION IS A FINANCIAL DECISION

Do you wish that your business had booming sales, substantial customer demand and rapid growth? Be careful what you wish for. Many small business owners are unprepared for success. If you fail to forecast and prepare for growth, you may be unable to bridge the ever-widening financial gap between the money coming in and the money going out. In other words, by failing to manage your cash flow, good news often turns to bad.

At the same time, your business may be suddenly pummeled by a change in the economic climate, or by a string of bad luck. If you're not prepared with a "what if" financial plan for emergencies, even a temporary downturn can become a business-ending tailspin.

YOU CAN DO IT!

That's why every decision you make in your business—whether it's creating a website, investing in classified ads, or hiring an employee—has a financial impact. And each business decision affects your cash flow—the amount of money that comes in and goes out of your business.

We'll help you with your decision-making with this online primer. Throughout this guide, you'll find case-studies, examples, and expert guidance on every aspect of small business finances. You'll see that our goal is the same as yours—to make your business financially successful.

FOUR KEYS TO SUCCESS

Maximize your income and the speed with which you get paid.
Throughout this site, we offer tips and checklists for dealing with maximizing income. We also concentrate on the biggest contributor to cash flow problems—late payments.

Minimize your expenses.
Can you lower expenses when the costs for everything—inventory, rent, insurance and employees—seem to keep rising? Surprise! We'll show you how even the leanest business can shed a few pounds.

Be prepared.
You can never completely avoid cash flow problems—unpredictable and catastrophic events can overtake any small business owner. But our financial strategies can prepare you for economic downturns, faltering suppliers, and sudden growth spurts.

Know your funding options.
Are you borrowing money because of a temporary negative cash flow or because of a fundamental problem with your business? Learn the difference so you won't find yourself shoveling your way out of a mountain of debt.

What is Cash Flow and why is it Essential to Business Success?

THE KEY TO BUSINESS SURVIVAL

You've probably heard people complain about cash flow and maybe wondered exactly what that means. Simply put, the money that comes in and goes out of your business is your cash flow. In good times, proper cash flow management is the key to profitability. In hard times, cash flow management is the key to survivability—allowing you, for example, to pay employees and your rent even when a major customer goes belly up. Think of cash flow as your business's lifeblood. If it is interrupted—and this is true even for highly profitable ventures—it can lead to a business's cardiac arrest.

"Cash flow is really no different than a family budget," says SCORE counselor Charles Christiansen. "If you know what your paycheck is and if you know what your expenses are, then you know whether or not you can afford to go out to dinner. That's basic cash flow, knowing when to spend and when not to spend money."

KNOWLEDGE IS KING

SCORE counselor Bill Bunten concurs: "Cash flow is about knowing when to buy things, how to buy things, and when you do buy them, knowing how much will be left over to pay for other expenses." As an example of questionable cash flow management, Bunten cited a printing business that got a big job, ordered a lot of paper to do the job, got paid for the work and immediately spent all the income on a brand new printing press. Unfortunately, the owner hadn't paid the invoice for the paper. The result—the owner created a cash flow problem by failing to account for costs before making a major purchase.

You can avoid many common cash flow problems by speeding up the payments of accounts receivable— for example through the acceptance of payment cards (whether through credit or debit cards). You can also head off cash flow dilemmas by running monthly reports—particularly an income statement and a statement of accounts receivable—on a regular basis. "Once owners see the cash stream running every month, then they can prepare; they can start making changes," says SCORE counselor Bill Ranganath. We'll show you how to generate these reports in the section on Reports and Forecasting.

Question: What do Richard Branson, Walt Disney, Coco Chanel, Henry Ford, and Milton Hershey all have in common?

Answer: They all created business empires without earning a high school diploma. But even though you don't need a formal education to put out an "Open for Business" sign, you still have to understand some accounting principles, take care of bookkeeping procedures, and most importantly, be able to make basic decisions based on your information. So, don't let a fear of math keep you away from business finances. We talk about how to implement some number crunching solutions in the section, Accounting and Bookkeeping.

Know the Numbers

THE NUMBERS YOU NEED

The key to making the right financial decisions for your business is having the right information. Running a business without reliable financial information is like driving a car without a gas gauge. If you don't have the numbers—and the skill to interpret them—your business will eventually run out of gas.

What types of numbers do you need to know? You'll need to know how much cash your business has on hand today, next week, next month, and perhaps next year. You'll need to know your rate of growth, your profit margin and the amount of money invested in your inventory, and you'll need to know how much you are owed and what accounts are past due.

NEED HELP MANAGING?

If you're looking for help managing your numbers, then you've come to the right place. We can help you get a grip on managing your cash flow and we can provide tips on how to prosper in the good times and survive the bad. If you already know basic accounting principles, this website can help you sharpen your skills.

> **Think you're already an expert on small business finance? Test yourself by reviewing the following case study:**
> Warren imports and sells carved wooden roses. He pays his supplier $.50 per rose and sells them for $1.00. Almost all the sales of wooden roses are in anticipation of Valentine's and Mother's Day—for example, this year he sold 200,000 roses for Valentine's Day and Mother's Day. Now, it's July and his supplier makes him an offer that's hard to refuse—he can order 400,000 wooden roses in July at $.25 per rose instead of his usual rate of $.50 a rose. But he doesn't have $100,000 in July to pay the vendor for the roses. What should he do?

Response to Case Study Question:
If your response was that Warren should borrow the money to buy the roses, then you may want to review the questions and comments posed by SCORE counselor Richard Stumbo, below. (Throughout this website we've included the opinions of business counselors from SCORE (www.score.org), a nonprofit association dedicated to educating and assisting small business owners.)

- **What are the sales conditions?**
  According to Richard Stumbo, the first issue is whether Warren can sell this volume of wooden roses. "He may have sold 200,000 roses in one year," said Stumbo, "but has he examined whether sales conditions have changed? Is Warren sure that the product won't be obsolete next year?"

- **What are the supplier terms?**
  If Warren is convinced he can sell the merchandise, he needs to see if he can find a solution with his supplier. Payment terms are a cost and the longer Warren can delay payment, the more of a cost reduction. Can he set up to pay a portion of the payment now, and a portion after the holidays?

- **Is the inventory managed efficiently?**
  Managing inventory—in this case, the storage and maintenance of the wooden roses—is also a cost. "Warren should not have to sit with this inventory from August through January," says Stumbo, "so if possible, he needs to find out if his supplier will ship the roses over time making sure the deliveries arrive for the holidays. With this approach, the supplier pays for inventory storage and related costs." And in terms of excess inventory after the holidays, will the supplier, after the season, accept credit for excess inventory? "That way," says Stumbo, "at least Warren can return unsold items and receive some value for his unsold inventory."

- **Does borrowing make sense?**
  "The first litmus test of any business loan," says Stumbo, "is that you need to earn more money on the loan than it costs to borrow it." Depending on the interest rate, length of loan, and sales conditions for the roses, the loan may not make sense. For example, imagine Warren borrows at a 10% interest rate over two years but during that time is only able to sell half the roses. "Warren will be chasing debt while carrying a great deal of unsold merchandise. That's going to seriously affect his cash flow," says Stumbo.

As Warren's rose-purchasing dilemma demonstrates, even a basic business decision—whether to buy inventory at a reduced rate—can trigger financial issues that later affect your cash flow.

What Can You do Now to Better Manage Your Finances?

THREE MANAGEMENT STRATEGIES

If you're looking at a jumbled pile of receipts in a shoe box and adding up sales with a solar calculator, it's probably time for a change.

Here's what you can do now to improve your financial management.

- **Adopt strategies that protect your cash flow.**
  If you don't adopt cash flow policies, you may find yourself wondering why you can't meet payroll. We explain five strategies you can implement immediately to survive economic downturns and thrive during the good times.

- **Maintain reliable bookkeeping and accounting procedures.**
  If you don't already use reliable procedures and systems, you'll need to put them in place. We show you how in the section on accounting and bookkeeping.

- **Create and read financial reports.**
  If you don't know how to read reports, you'll need to learn. We explain how in the section on financial forecasting.

MAXIMIZE INCOME

- Introduction
- Profits, Income and Pricing
- Extending Credit
- Get Paid Quickly
- When Income is from One Customer
- When Income is Seasonal
- When Income is from an Insurer
- Diversify Your Income

Introduction

SOME COMMON INCOME ISSUES

Increased sales don't always mean increased profits. That's because a sale one month may not mean a payment until several months later. Maximizing income becomes even more difficult when the revenue is seasonal, or only from one customer. In this section we'll look at common income issues and prescribe some cash flow solutions.

Profits, income and pricing.
The distinction between profits, income and pricing affects your cash on hand.

Extending credit.
Learn when and how to extend credit to your customers.

Get paid quickly .
Sometimes the biggest challenge for a small business owner comes in the final stage of a transaction—the part when the customer is supposed to give you the money.

When income is from a single customer.
Whether by choice or circumstances, some businesses must place all their eggs in one customer's basket. Are you aware of the risks?

When income is seasonal.
How do businesses deal with seasonal income?

When income is from an insurer.
What to do if you rely on insurers for payment?

Diversify your income.
Diversification comes in many colors. Are any of them right for your business?

The Relationship Between Profits, Income, and Pricing

HAVING CASH ISN'T THE SAME AS HAVING A PROFIT

Many small businesses withdraw cash from the business under the mistaken impression that they are paying themselves with the profit. But there's a big difference between making a profit and having cash.

You can avoid this misunderstanding—and best determine your actual net profits—by generating and reviewing an income statement. An income statement identifies your gross profit (income minus direct cost of goods sold or "COGS") and your net profit (your income minus all costs).

> **Test yourself by reviewing the following case study:**
> Susan operates a surfboard shop and also offers surfing lessons. She's priced her surfing lessons lower than her competitors because she considers the lessons to be pure profit. After all, there are no direct costs except her time. Yet, for some reason, when she does her annual audit, her business never seems to make as much money as she expects.
>
> **Response to case study:**
> When Susan runs an income statement she sees that although there are no direct costs for her lessons, there are operating or fixed expenses associated with them—specifically insurance. She had been associating the insurance policy with the retail business but the biggest chunk of the insurance payment was actually attributable to liability insurance for the lessons. When she subtracted the annual liability insurance costs directly from the annual revenue from the lessons, she realized she needed to price them higher in order to justify the insurance expense.

PRICING YOUR PRODUCTS

How does this relate to profit? As you can see from the hypothetical, one of the benefits of distinguishing profits from income is that it allows you to revisit your pricing. If you see that you're barely profiting from one item or service, you may want to reconsider whether to re-price the item (or discontinue it entirely). In addition to competition, your pricing may be affected by elements such as value, demand, and costs.

"A common mistake made by small business owners is pricing too low," says SCORE counselor Stanley Lakefish. "I've never known a business to go south due to high prices," he says, "but I've known a few that did fail due to their prices being too low. Don't sell your product or service short. If you can deliver, charge accordingly."

When Should You Extend Credit?

MAKE SURE YOU GET PAID

When you invoice a customer and require payment within 30, 60, or 90 days, your business is extending credit. You may not feel like you're extending credit—after all, you're just waiting for payment—but from a legal perspective, you're making an unsecured loan. (A secured loan is one in which the borrower would pledge property as a collateral for the loan.) The problem with unsecured loans is that they're … well, unsecured. If the customer doesn't have the money, it won't do any good to sue, because there will be nothing to recover. If the customer goes bankrupt, you're out of luck. Here's a short checklist to ensure getting paid.

- **Accept payments via credit or debit cards.**
  Credit and debit cards—have the potential of removing you from the collections business (and they provide additional benefits of flexibility and convenience).

- **Check the creditworthiness of new customers.**
  You can get credit research from companies such as Dun & Bradstreet, BusinessCreditUSA, or Equifax.

- **Use a credit reference form.**
  A good credit reference form should ask who is in charge of the business, who to contact when problems develop, how much credit the applicant is seeking, other firms with which the applicant has done business on credit, and any other information needed for making your decision.

- **Analyze for credit risks.**
  How do you tell whether the customer is a risk? If a customer has one or two minor credit blemishes—perhaps the result of an unexpected growth spurt—that should not necessarily be the basis of denying credit. But watch out for a client or customer with a record of not paying bills.

Get Paid Quickly and Predictably

WORKING WITH TROUBLED CLIENTS

As you're probably aware, making a sale doesn't automatically mean you've received the cash. "It's only cash when you get the money," says SCORE counselor Bill Ranganath. "That's why pursuing late-paying customers must be one of your business's highest priorities."

Late-paying customers usually fall into three categories:

- Customers who want to pay but, because of real financial problems, can't do it on time.
- Customers who prefer to delay or juggle payments, and
- Customers who will do whatever possible to avoid any payment

For the first two categories, there is hope. You may be able to manage these debts and to convince the debtors to make partial or full payment. This is especially true if you have customer loyalty and your customers sincerely want to support you. As for the last category, you need to recognize this type as quickly as possible and take serious action—perhaps turning the account over to a collection agency. Below, we'll help you analyze your customers so you can separate a deadbeat from a struggling account that deserves some slack.

Most professional bill collectors agree that payment problems are solved by effective communication. Getting paid can even be viewed as an element of your marketing plan. If you can work with financially troubled clients, as they make their way through a rough patch, you may end up with devoted customers for life.

- **Get busy and stay at it until you're paid.**
  According to a survey by the Commercial Collection Agency Association, after only three months, the probability of collecting a delinquent account drops to 73%. After six months, it's down to 57%. After one year, the chance of ever collecting on a past due account is a dismal 29%. "Whether times are good or bad, you should always follow up receivables promptly," says SCORE counselor Frank Wey. "If you give 30 days, on the 35th day you should be on the phone. That's a rule that doesn't depend on the business environment."

- **Accept electronic payments.**
  If you are not accepting credit and debit cards, now is the time to establish an electronic payment account. Accepting credit and debit cards can speed the payment period to 4-5 days (instead of 30-60 days). And in a difficult business environment, an electronic account guarantees payment and reduces the risk of default.

- **Don't harass creditors.**
  It's rarely a successful strategy and it's sometimes illegal. If a customer asks that you stop calling, then stop calling. If a customer asks you to call at another time, find out the right time to call, and call then. Don't leave more than one phone message a day for a debtor, and never threaten the debtor or leave messages that describe the debtor in a bad light.

- **Look for creative solutions.**
  If the customer has genuine financial problems, ask what amount they can realistically afford. Consider extending the time for payment if the customer agrees in writing to a new payment schedule.

- **Write demand letters.**
  Along with phone calls, send a series of letters that escalate in intensity. You can find sample collection letters (sometimes referred to as "demand letters") online. You can also pay a collection agency a fixed fee to write a series of letters on your behalf.

When Your Income is from Only One Customer

THE 'EGGS IN ONE BASKET' DILEMMA

"Having all your eggs in one basket is always a dangerous situation," says SCORE counselor Chet Ross, "especially if that customer is a slow pay. It's devastating because by extending credit, you're becoming their bank. And if you're tied to one customer and that customer is sold or runs into a problem they'll take you down." Ross acknowledges that you can't fix the one-customer situation overnight. "You need to set plans or goals to attract additional customers and then slowly work towards those goals."

Having one customer is a balancing act. On one hand, you're rooting for the customer and hoping they will continue to like your service. On the other hand, says SCORE counselor Robert Edeburn, you have to work very hard at building your own enterprise so that the failure of the one customer will not put you out of business. Edeburn suggests having regular meetings with the customer to monitor how their business is going and to find out if there are ways you can be of more help. Edeburn also advises that before making any major investments try to get a long term commitment from the customer, one that allows for price adjustments.

SMALL ACCOUNTS CAN HELP

If you find yourself growing quickly with one customer, you may be tempted to terminate smaller accounts. Smaller accounts give a business a constant, reliable source of income even if it is dwarfed by large orders from one customer. "These secondary sources of income can be particularly helpful to a manufacturer who's dealing primarily with one large retailer," says SCORE counselor Larry Lakin. "Often these retailers can help you establish a market or test-market a product. Testing like this can help you determine whether to commit to the manufacturing. And if the product succeeds in the smaller store, or with a niche retailer, the manufacturer has more of a story when he wants to take it to Wal-Mart."

- **Run periodic credit checks on your prime customer.**
  Don't rely on assumptions and data from last year. You owe it to yourself to stay abreast of your big customer's credit worthiness.

- **Create a survival a plan if your prime customer goes under.**
  Your plan may include cost-cutting, hibernation, or borrowing. No plan is perfect, but—like keeping a flashlight under the bed—it's good to know it's there.

- **Understand exclusivity.**
  Exclusive arrangements—sometimes common with large accounts—prohibit you from supplying to others. These arrangements can be very profitable but they can also be a ball and chain. If you are tied to an exclusive deal, ask for a written agreement with regular guarantees—for example minimum annual guarantees, and if possible price adjustments.

How Do Businesses Deal with Seasonal Income?

SPRING, SUMMER, WINTER … FAIL?

When it comes to seasonal income, it's not so much a matter of getting paid on time—you already know with some certainty when you'll be paid—it's how to deal with the lack of income throughout the rest of the year. Obviously, you can't just close your store for nine months of the year—that would create some seriously nonproductive real estate. So how do businesses that earn 80% of their revenue in the last quarter manage to survive throughout the year?

"If you make most of your money in the last quarter," says SCORE counselor Bill Ranganath, "you really need to control cash and costs for the year. One of your goals is to avoid carrying that seasonal inventory for the whole year. Another goal is to minimize your staffing expenses. The common approach is to add sales people and temps in that final quarter." In any event, you need to constantly review staffing costs. Another solution may be to consider product diversification.

> **Test yourself by reviewing the following case study:**
> Frank owns a nursery that generates almost all of its revenue during the second quarter of each year. Each year, Frank finds it harder to compete with national chains including home supply stores that offer a wide range of gardening and related products. Frank is also having difficulty paying fixed expenses—for example, rent, a few full-time employees—during the quarters when revenue is low. Should Frank borrow money from his father-in-law to bridge the gap during the slow months?
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> **Review of case study:**
> In general, Frank should be careful about borrowing since experts agree that it's best to avoid going into debt for seasonal needs. If you do borrow for seasonal requirements, seek short-term borrowing. That is, you should try to repay a loan like this quickly. SCORE counselor Stanley Lakefish, who once owned an "unbelievably seasonal" mailing business, claimed he sometimes went overboard trying to put aside money during the busy season to carry the company through the tough times. "From time to time, I personally loaned the company money on a short-term basis." Lakefish also acknowledges that a reasonable solution may be a line of credit from a bank.
>
> CAN YOU DIVERSIFY?
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> SCORE counselor Larry Lakin, who has had experience in the nursery industry, suggests diversification as an alternative. "Every nursery needs year round products. They might not be enough to carry the store but they should be enough to pay most of your expenses and minimize off-season losses. At the nursery chain where I worked, they tried selling crafts, and home décor with some relationship to nursery, types of garden décor. I've seen other nurseries getting into gift lines or pet food. That's often very difficult to

accomplish. A successful nursery will also have to cut costs as much as possible, and reduce staff to as a low as possible—perhaps rely on temp employees along with one key permanent employee like a store manager."

What if You Rely on Insurers for Payment?

THE CHECK IS NOT IN THE MAIL

Businesses that rely on payments from insurers are prone to cash flow problems. Not only is the insurance payment often a long time coming—sometimes as late as 120 days after invoicing—but the insurer often cuts a portion of the bill, claiming that it's not covered by the policy. No wonder your dentist wants to drop all his insured clients.

In order to stay open, a business that relies on insurance income needs to manage billings and if possible, to add non-insured billings into the income mix. Many such businesses use third-party claims processors—companies that will bill and collect insurance payments on your behalf. That frees you from some administrative tasks and sometimes makes the collection process less cumbersome. But using a third-party agent doesn't relieve you from monitoring claims for timeliness and accuracy (see below for an example).

SCORE counselor Charles Christiansen tells the story of a nurse practitioner who outsourced her insurance billing to a third party contractor who took care of insurance billing. Unfortunately, she learned too late that the contractor had failed to bill approximately $12,000. "If you outsource," says Christiansen, "you need to stay on top of it. You should know whether all of your accounts have been billed and you should check with your contractor every month for a report or statement of billings, even if it's a summary chart. You need procedures to monitor all parties, check that all of the codes are in place and track the billing diligently."

Diversify Your Sources of Income

FROM TOYS TO DIAPERS

Handled properly, diversification can reduce financial risk and improve cash flow—for example when Toys R Us began selling diapers in order to attract customers during slow selling seasons. But an unsuccessful diversification can drain cash and divert a business from its mission. What exactly does it mean to diversify?

There are four common flavors:

- **Sell a new related product or service.**
  Example: Celestial Seasonings, known for selling tea, began selling coffee.

- **Adopt existing products or technology.**
  Example: The military Humvee was converted to the consumer Hummer; the makers of Arm & Hammer baking soda sold Arm & Hammer Baking Soda Tooth Powder.

- **Offer a new unrelated product or service.**
  Example: The Virgin retail chain went into the airline and mobile phone businesses.

- **Offer products or services that compete with your suppliers or customers.**
  Example: Armani opened retail stores; Netflix began producing and distributing movies.

"If you're going to seek a diversified source of revenue from different products," says SCORE counselor Chet Ross, "then these products should be central and complimentary to the business. The diversification needs to have logic. A plumbing service might very well do heating. An auto dealership might stock pickups but they may or not stock delivery vans. It really depends on what the business can handle. A concentration in one area can leave you vulnerable." At the same time diversification should not be the cause of a product glut. "Simply having a proliferation of products is not the answer," says Ross.

DIVERSIFY WITH ONLINE ADVERTISING

Diversification of revenue may also include advertising revenue. For example, many companies who have established an online presence have learned that additional revenue can be generated by including Google ads, affiliate programs (where the company gets paid when someone buys another company's product or service) or the use of banner ads.

Not everyone is a fan of diversification. "It can get you in trouble by leading you away from your vision and goals and it can cause mounting costs," says SCORE counselor Charles Christiansen. "Find what you're good at and stay within that. If you're in the furniture business, don't start selling snow cones unless it will keep the kids occupied while you're selling the parents some furniture."

BEFORE YOU DIVERSIFY

Before you diversify, consider the following questions.

- **Do you have a good reason for diversifying?**
  You should have a reason—for example, seasonal sales—that justifies taking time away from your primary products or services.

- **Is the timing right?**
  Are you diversifying at a time when you (and your management) need to remain focused on the core business?

- **Do you have the skills and knowledge?**
  Do you have what it takes to successfully promote a new service or product? Without the ability to promote a diversified line, you're headed for a dilemma.

- **Have you considered the effects?**
  The rewards from diversity should offset some weakness in your current business. For example, a diversified line should provide you with income during an otherwise slow period.

- **Have you projected the potential for failure?**
  If a worst-case scenario shows that diversification will sink your business, you may not want to take the risk.

- **Is diversification a logical extension for your company?**
  If you are a retailer, can you diversify by offering related services—for example if you sell knitting supplies, can you provide knitting lessons?

MINIMIZE EXPENSES

- Introduction
- Spending and Taxes
- Fixed Expenses
- Employees versus Contractors
- Inventory Costs

Introduction

CUTTING COSTS

There's an old business maxim: Success is not based on how much a business takes in, but on how much it does not spend. In other words, the easiest way to increase profits is to lower expenses—whether that means lowering variable expenses (expenses that fluctuate based on your sales) or fixed expenses (expenses that don't vary from month to month).

If expenses keep rising, how do you go about lowering them? There's no secret to lowering costs. Determine your major costs and research alternatives for pricing and quality. If, for example, you're trying to get a better rate from your landlord, you can't do it without accurate marketplace knowledge about comparable rents. At the same time, keep in mind that the lower price quoted for that cell phone vendor, freight company, or importer, may also mean lower quality services (always a possibility). So, research should never be limited to price alone.

ASK FOR PRICE BREAKS

A penny-pinching mindset can sometimes be helpful but more important is a willingness to negotiate with everyone over everything. You may find it hard to ask for a price break but as the maxim goes: You'll never know unless you ask. Once you get over that hurdle, you may find that the attitude of negotiating price reductions is addictive.

Question: Can you guess the top six small business expenses?

Answer: According to a 2006 National Federation of Businesses (NFIB) survey, the top six small business expenses include:

- Cost of goods (materials and supplies that are direct costs of goods),
- Inventory acquisition and management,
- Wages, salaries and commissions,
- Employee benefits (excluding taxes such as FICA),
- Energy (electricity, gasoline, natural gas, etc.), and
- Rent

Other lesser expenses include interest expenses, vehicles, business insurance, and business taxes.
The business expenses that appear to be the most modest for small business owners are marketing and advertising, and professional services.

Spending and taxes.
Sometimes it pays to buy that new computer; sometimes it doesn't. Find out how spending can lower your taxes.

Fixed expenses.
Have you thought about lowering insurance costs or reducing lease payments? Consider ways to chip other fixed expenses.

Employees versus contractors.
Your choice of worker—independent contractor or employee—can make a big difference in your balance sheet and cash flow.

Inventory Costs.
Do you have an unnatural relationship with your inventory? Maybe it's time to end that love affair and cut some inventory costs.

Does Spending More on Business Mean You'll Pay Less Taxes?

DEDUCTIONS: NOT A DOLLAR-FOR-DOLLAR PROPOSITION

As a general rule, higher business expenses mean lower business taxes. That's because business expenses are tax deductible. A tax deduction is the cost or value of something that you can subtract from your gross income (all the money you earn) to determine your taxable income (the amount on which you have to pay tax). It's not a dollar-for-dollar proposition: You don't save the entire amount you paid for deductible goods and services. But because you don't have to pay tax on this amount, a deduction can save you almost half of what you spend.

The exact amount you'll save by taking a deduction depends on your tax bracket—the tax rate that applies to your income.

MEASURING DEDUCTIONS

The higher your bracket, the more every deduction is worth. Here's an example to show you how it works:

Case study:
Simon spends $2,000 on a computer for his business. He's in the 25% federal income tax bracket. How much does he save by claiming it as business deduction?

Review of case study.
By deducting the cost of the computer, Simon doesn't have to pay tax on $2,000 of his income. That saves him 25% of $2,000, or $500. But that's not all. The state where Simon does business imposes a 6% income tax, so Simon saves an additional $120 there. And Simon doesn't have to pay self-employment taxes—the amount self-employed people have to chip in to fund their Social Security and Medicare—on this money, either. The self-employment tax rate works out to about 12%, for an additional $240 savings. Simon ends up saving $860, almost half of what he paid for his computer.

Although you can save quite a bit on your taxes by maximizing your deductions, lowered taxes—by themselves—don't justify unnecessary business expenses. In Simon's case, for example, he's spending $2,000 in order to save $860. If he doesn't need the computer right now, that's $2000 the business has on hand to deal with potential cash flow problems.

OTHER WAYS TO SAVE

Looking for ways to save money? Have you considered any of these?

- **Earn points from loyalty programs.**
  Credit card companies (whether issuer or merchant accounts) commonly offer discounts and bonuses based on customer loyalty. This may include frequent flyer miles, discounts on hotels and rent-a-cars, and program points redeemable for office supplies or other merchandise.

- **Save on postage and delivery.**
  If you are concerned that you won't be able to email large files as attachments, check out services such as YouSendIt.com and MailBigFile.com. Concerned that you must use the mail in order to get signed documentation? Digital and emailed contracts are binding as long as the recipient provides some sort of electronic signature (which can be as informal as simply typing your name).

- **Keep down office supplies costs.**
  If you have considered the obvious cost-cutting concepts—buying reconditioned equipment, shopping in bulk at box stores, purchasing used merchandise at eBay, uBid, Yahoo Auctions, or Amazon—then look towards the less obvious culprit—employee theft. Lock up supplies if necessary or develop a sign-out system.

- **Cut your long distance and telephone charges.**
  Look into Internet telephone services such as Skype or Vonage that allow you to communicate nationally and internationally at a fraction of normal telephone rates. Call suppliers or customers on their 800 numbers.

- **Join something.**
  Trade and industry associations offer many cost-saving deals from rental cars to office supplies to insurance. In addition these organizations may provide you with information regarding inventory and profit ratios within your industry—an important way to track your success.

- **Maximize your tax deductions (and tax credits).**
  Once or twice a year review your tax deductions with your financial advisor. If you have a home-based business, there are many additional deductions you can deduct including a portion of your utilities bill.

- **Tradeoffs.**
  Many businesses look to make trades or barters to save money. A local theater may trade free tickets for discounts from its coffee supplier. A computer tech and a lawyer swap services. Two businesses may swap promotional mailing lists or may barter for supplies. National bartering networks also exist for small businesses but research them before joining. (Several have been investigated for fraud.) You must report bartered goods as income. The good news: your tax liability—particularly if you do a lot of bartering—is lower since the fair market value of bartered goods is usually less.

Understand and Lower Fixed Expenses

CUTTING INSURANCE, RENT AND WAGES

It's often easier for a small business owner to lower fixed expenses than variable expenses. That's because suppliers are not likely to reduce costs without incentives such as quick payment or volume orders. That's why you may have a better shot at reducing fixed expenses such as rent, travel, utilities, insurance, accounting costs, legal, and travel. Here are some suggestions for lowering three types of fixed expenses: insurance, rent, and wages.

INSURANCE

The best way to save money on business insurance is simply to work with a professional who will help you figure out what coverage you need and offer you a competitive price. An agent or broker is paid by the insurance company, by commission. Some of them are independent—that is, they shop around among various companies to find the right policy. Others work exclusively for one insurance company.

Obviously agents or brokers who work with only one company will try to sell you that company's products, often even if they don't provide the best coverage for your business or offer you the best price.

An independent agent or broker is also paid by commission, but will shop around to find you the right coverage at the right price.

FINDING THE RIGHT INSURANCE PRO

The process of finding the right insurance pro is a lot like finding the right accountant, lawyer, or other professional. The best place to start is by asking for recommendations from others who do business in your field. Ideally, you want some who will periodically provide you with information about new policies, give you quotes from other companies from time to time, and help you if you have to file a claim.

- **Reduce risks.**
  Risk management minimizes your insurance claims and brings your premiums down. Implement procedures to make sure that you aren't taking on risky employees—for example, by checking the driving record of anyone who will drive for you. Many companies offer lower premiums or discounts to policyholders who take certain safety precautions. Installing smoke detectors or a security system are a couple of steps you can take that may get you a lower-priced policy.

- **Find out if a client's insurance will cover your business.**
  In some business fields, your clients may have to provide the insurance. That can save you policy dollars.

- **Prioritize your greatest risks.**
  Once you've dealt with required coverage, spend your money where you need it the most. If you face a serious risk of a loss that could wipe you out, put your insurance dollars there first.

- **Don't duplicate coverage.**
  Carefully review your homeowner's or renter's insurance policy, for example. If you have only a few relatively inexpensive pieces of business equipment, your existing property coverage may be adequate. Or, you may be able to purchase an inexpensive endorsement to increase your coverage. Home-based businesses that have few business-related visitors can often get a relatively inexpensive liability endorsement. You can also add an endorsement to increase coverage for business equipment.

- **Consider insurance through an association.**
  If you belong to a trade organization, professional group, or other business association, you may be eligible for special rates on certain types of insurance.

FIXED EXPENSES: YOUR LEASE. IS A LONG-TERM OR SHORT-TERM LEASE BETTER?

You're better off with a long-term lease if your rent is low and commercial property values increase. A short-term lease is better if commercial property values decrease and comparable properties rent for less. That's because you will get out of the lease sooner and be able to negotiate a newer better deal. So, in order to best protect your cash flow, you have to guess at what's going to be happening with this particular property within the next few years and what's likely to be happening with your business.

RENEGOTIATE YOUR LEASE

Once the lease is signed you may be able to renegotiate in certain circumstances. If the value of similar commercial property has dropped, and if you're close to renewal you can tell your landlord, "I'm overpaying for rent now. If you renegotiate and give me a better rate, I will agree to a renewal. Otherwise I may take my chances and look for a new place." A riskier approach is if your business is having serious problems. You can tell the landlord, "Look, given the current business climate, I'm going to have trouble under the terms of the existing lease but if we can renegotiate, I can remain." In other words, you're advising the landlord to either renegotiate or end up with a defaulting tenant—always a money-losing situation for a landlord in poor economic times. The risk, however, is that if you personally guaranteed the lease—which is quite common—the landlord can go after your personal assets if you default.

Employees versus Contractors

WHICH IS BETTER FOR YOUR BUSINESS?

When it comes to workers, one of the first questions to be considered is whether a business saves more money hiring an employee or an independent contractor. Sometimes, the business doesn't have any choice; the IRS guidelines mandate that you treat the worker as an employee. (You can learn how to classify employees and contractors at the IRS website [www.irs.gov].) In other cases, the employer has a choice.

> **Test yourself by considering the following case study:**
> You want to bring a retail business online. You need someone to create and manage a website and you determine the work will take 120 hours a month. You don't know whether to hire an employee to do this at $12 an hour (for a total of $1440 in wages per month), or to hire an independent contractor who will charge $2000 a month for the job. What are the variables that need to be considered?
>
> **Review of case study.**
> SCORE counselor Charles Christiansen reviewed this hypothetical and declared the answer to be a 'no-brainer.' His advice: hire the contractor. Christiansen suggests proceeding as follows: First he advised putting together a job description—that is, what you want the worker to do, what type of site is needed with what functions. Then ask questions—for example, does the $12 an hour employee have the expertise to do what has to be done. "It's not just development of a site," said Christiansen, "because there are millions of websites that are no good – they're hard to open, too tough to navigate—but it's developing a website that meets all of your requirements."

GETTING A WORKER UP TO SPEED

Next question to ask, are you going to direct this person? And if so, what level of expertise do you have to direct this? Third question, if you hire the $12 an hour employee, do you have any idea what it costs to bring them up to speed? Some companies have found that it costs up to $25,000 to bring an employee up to speed. Christiansen's fourth question: What really goes into the employee's paycheck? It's not just the $12. The benefit package – even the minimum that the government requires is 7.6% of salary. The average will be 15% or actually $13.80 per hour. The benefits could even go as high as 25% which makes it $15 an hour. In other words, even if you stuck to the 120 hours with your employee, the salary costs alone could be between $1800 and $2400. Says Christiansen, "Hiring the experienced outside independent contractor makes much more sense."

As the hypothetical demonstrates, there are many variables at play when choosing what type of worker to hire and the associated costs.

Lowering Staff Expenses

Here are some things to consider if you're trying to lower staffing expenses.

- **Examine sales and productivity on an hour by hour basis.**
  SCORE counselor Robert Edeburn suggests tracking productivity over a period of weeks (or months) to discern a pattern of when the business is slow. Comparing the activity during the slow times with the periods of higher activity would give the owner a good basis to determine staffing.

- **Wages should be based on value.**
  Most experts agree that it's best to pay employees based on their value to your business not based on a set rate for all employees. In other words, always reward the most productive, valuable employees.

- **Calculate the "up and running" time.**
  Unlike an employee, who may need training and guidance from you, an IC is likely to have enough experience to jump right into a difficult project.

- **Consider the paperwork.**
  If you have a fear of bureaucratic paperwork, avoid hiring employees when possible. (Remember, there are some cases when the IRS mandates who is an employee). With contractors, you won't have to worry about all of the laws that apply to employees, from overtime to rest breaks to antidiscrimination rules to providing time off.

- **Consider mixing temps and full-timers.**
  Sometimes the best approach may be to mix temporary and full-time employees. "The key to doing that," says SCORE counselor Larry Lakin, "is to identify your potential stars and make sure you're promoting and giving them more responsibility. Focus on keeping those high potential individuals. Then you can keep costs down by bringing in temp people for much of the other work. In my experience hiring a temp worker doesn't mean that the people are not as qualified or as good. Sometimes the temp people are highly qualified people who only want to work 20 or 30 hours. Often temps turn out be really quite dependable and reliable. They just want to work less hours."

Inventory Costs

DON'T FALL IN LOVE WITH YOUR INVENTORY

If you sell or manufacture products then you're aware of the costs to maintain inventory, especially when it sits unsold in your warehouse, garage, or basement. As SCORE counselor Chet Ross points out, "Inventory is money. It's cash that's tied up. And it has many associated costs." So, how can you cut inventory costs?

SCORE counselor Stanley Lakefish, who spent 25 years in the wholesale magazine distribution business says inventory was one of his biggest challenges. "The most common mistake was too much inventory. That created cash flow issues, as well as increased costs (for handling the inventory)." One thing that helped Lakefish was to track his inventory turnover and compare it to industry norms and ratios. He obtained these industry statistics by joining trade associations.

Here are some considerations if you're managing inventory.

- **Don't fall in love with your inventory.**
  Get rid of slow-moving inventory at any price in order to get the cash back into the business and working for you. "Retailers love to go to shows and buy stuff," says SCORE counselor Charles Christiansen, "and they love to get the shelves in their store really full. The problem is that they don't manage their inventory. They're better buyers than they're sellers. And if they've got a slow seller they won't sell at break-even or loss. Instead they'll say, 'Oh somebody will buy it someday.'"

- **Understand inventory turns and profit margins.**
  Usually, the greater the number of inventory turns per year (the amount of time it takes to sell out your inventory), the narrower you can make your profit margins (and the lower your prices). For example, points out Charles Christiansen, a national grocery chain can sell at a narrow margin because they turn at least fifty times a year. At the same time, by turning so much inventory, the grocery chain has more buying power and can seek lower prices. But a jewelry store has wider margins because they turn on an average of 1 to 2 times a year. "If you don't understand those principles," says Christiansen, "you'll be wondering where the money is."

- **Keep 'just-in-time' inventory, not 'just-in-case' inventory.**
  SCORE counselor Chet Ross says just-in-time inventory is what the auto companies and a lot of other companies use—it's just the right amount of inventory at the right time (with the ability to keep more when needed). Just-in-case inventory is the opposite; it's when you maintain too much and too varied an inventory.

- **Maintain a conservative inventory.**
  When it comes to inventory, it's not a sin to be thin. SCORE counselor Larry Lakin advises that it's always better to err on being a little thin on inventory. "Don't just skinny it down; you need enough to do a full presentation. But be conservative and focus on stocking strong sellers. And always have sources of supply available that allow you to bump up your inventory if you need to."

- **Cut inventory costs when possible.**
  Depending on your needs, try to find creative ways to cut costs. Chet Ross provides an example, "If you depend on an off-shore supplier, you might keep a lot of inventory because of the transit time required to supply you with products or materials. In that situation, you may want to change the method of shipment from surface to air and therefore reduce the supply on hand." In other words look for ways of shifting your inventory burdens to others.

BE PREPARED

Introduction

EMERGENCY STRATEGIES

Every business gets side-swiped by the unexpected, whether it's an economic downturn or just a string of bad luck. Usually you can't predict most small business disasters. But when they strike you can—as with any disaster—be prepared to implement a strategy. With the right attitude and some flexibility in your planning, you can prevent a temporary downturn from becoming a business-ending tailspin.

Economic downturns.
A rising tide lifts all boats. But what happens when the tide drops and takes your business with it? Here are some suggestions for dealing with tough times.

Start-up problems.
The launch can be the biggest financial challenge for a new business. Here are a few suggestions.

Sudden growth spurts.
Strange as it seems, sudden growth often makes it harder, not easier, for a business to succeed.

Paying bills.
What do you do if you owe four bills but can only pay three? Here are some suggestions for staying afloat and keeping most of your creditors happy.

How do You Deal with Economic Downturns?

STEERING THROUGH THE STORM

Some businesses appear doomed to extinction no matter what the economic conditions—for example, record stores and film manufacturers. But for most other business owners, the major concern is a bad business climate. What can you expect when the economy slips? You can definitely expect accounts receivable to slow up (since other business won't be able to pay on time), and you should also expect to carry an excess in inventory (as sales slow).

Economic downturns require immediate attention. SCORE counselor Stanley Lakefish advises quick responses and diligent monitoring of your numbers. "Stay on top of the accounts receivables and inventories and try to keep sales and payroll within the proper parameters. For example, if payroll should be 12% [of your budget], then adjust hours to stay within that range."

Question: How do you prevent a vendor's cash flow problem from becoming yours?

Answer: One SCORE counselor had a simple answer when a vendor or supplier had financial problems: "Find another vendor." In other words, adopt a zero tolerance attitude for any sinking ships in your network. Most counselors concurred: you must not allow suppliers' problems to become your problem.

It's not always possible (and you may not always want) to immediately abandon a vendor in trouble. In that case you'll need to monitor your vendors by getting current and accurate information. If you don't talk to your vendors, you may not learn they're headed to bankruptcy court … until you open your mail. Don't be shy about asking questions. Consider running annual credit reports on your major suppliers to see if they are having problems.

Here are a few things to consider during tough economic times.

- **Reassess variable costs and discretionary expenses.**
  SCORE counselor Chet Ross says that when there's a downturn, "you have to go back to ground zero with budgeting and look at all your activities, everything that's going on, and everything that's planned. You need to take a hard look at variable expenses and how to minimize them."

- **Minimize staffing expenses by outsourcing.**
  Ross points out that small business owners are constrained by staffing. "You can try outsourcing when possible if the volume drops down. Outsourcing can provide additional capacity without the problems of laying off people and the attendant costs that go with that."

- **Cut customers.**
  This may sound counter-intuitive but sometimes it helps to revisit your customer base, particularly those that are considerably past due. "The last thing you need right now," says Ross, "are material shortfalls in revenue."

- **Reduce inventories.**
  Ross suggests that now is a good time to look at marginal product areas and decide if you want to cut inventory.

- **Ask for help.**
  Don't be shy about asking others—particularly loyal employees, customers, or vendors—for help. Employees may be able to make concessions or offer suggestions that will help you get through the hard times. The same is true for customers and vendors who want you to survive.

- **Consider discounts.**
  Sometimes, the only way to keep the doors open is to cut fees and prices. We're not advising a permanent across-the-board cut, but consider offering a dramatic one-time cut on certain items, for example, lowering sandwich menu prices, or providing a one-time discount on dog shampoos.

- **Seek Short-Term Financing Solutions.**
  Credit card programs, with their flexibility and financing solutions may provide a short-term funding solution for hard times. In addition, card programs offer discounts and bonuses based on customer loyalty.

Dealing with Start-Up Problems

PLAN, FORECAST AND CAPITALIZE

Starting up a business requires a great deal of energy and navigation. SCORE counselor Charles Christiansen offers three tips:

- **Have a strategic plan.**
  There's a difference between a business plan and a strategic plan. "A business plan is cold and it's a collection of facts, forecasts, and assumptions and risk assessment. A strategic plan is your vision, your core values, your purpose in having a business and its goals. Your vision and your plan have to match." In other words, the strength that will get you through those initial challenging months comes from a personal vision, not a business projection.

- **Check your forecasts regularly.**
  If you have prepared a business plan and financial forecasts, don't put those in a drawer and forget about them once you've gotten funding. "Your plan is a living document," says Christiansen. "It's a fluid document and you need to evaluate it at predetermined times and ask 'Am I on target? What adjustments do I have to make in order to succeed?'"

- **Make sure you're capitalized.**
  "The biggest problem for start-ups," says Christiansen, "is undercapitalization. They don't start with enough. They never planned for start-up costs and the day they open the door they're in trouble. They're worried about bills and they devote their efforts to that instead of to marketing."

Are You Prepared for Sudden Growth Spurts?

SUCCESS CAN BE DANGEROUS

"Sudden growth can be the worst thing in the world," says SCORE counselor Frank Wey, an expert on credit management and the author of Insights into Financial Statements and Financial Statement Analysis For The Credit Professional. Wey, who teaches a course on credit management, gave a hypothetical to his class in which a business's sales increased 8 to 10%. In a second hypothetical, the same business had a 40% growth spurt. Conclusion: in the 40% growth hypothetical, the business was forced to close because too much cash was required during the growth spurt. Here are two tips:

- **Avoid long-term borrowing.**
  "Dramatic growth is not going to be solved by long-term borrowing," says Frank Wey. "That's a dangerous way to go about it because your debt to worth ratio is going to get way out of whack—that is you'll owe far more money than you own." Instead look to your bank for a revolving line of credit. That way if growth causes a dip in cash, you can still pay your bills.

- **Have sufficient people, equipment, and floor space.**
  Growth consumes everything in its path. You need to assess (hopefully with financial projections) how much 'front-loading' you'll need to do so that if you do borrow, you've asked for enough.

- **Credit cards and lines of credit can help bridge key growth spurts.**
  Sometimes dramatic growth can best be managed by tapping credit cards and lines of credit, both of which offer flexibility and additional options.

If Cash is Tight, in What Order Should You Pay Bills?

NEGOTIATE SMART PAYMENT TERMS

Your goal is to pay your bills on time because by doing so, you encourage a sense of credit worthiness and trust that may enable you to survive periods of cash flow shortages. If you cannot pay on time, you should always keep the creditor, contractor, or vendor fully informed and explain when you plan to pay, and if necessary, the reasons for the problem. If you're headed into a deeper or more long-term financial morass, then you'll need to negotiate longer payment terms. And, as SCORE counselor Frank Wey points out, you'll need to maintain and meet those extended payment terms if you want to retain trust.

- **Pay the government first.**
  SCORE counselor Charles Christiansen always advises paying the government first. "The government can shut you down in fifteen minutes and they can go into your personal bank account."

- **Consider Short-Term Credit Card Financing.**
  When you are pinned to the wall by accounts payable, credit cards may provide the necessary bridge-financing

- **Pay to keep the doors open.**
  After you pay the government, you should pay the bills that keep your business going—for example, if there is inventory you need, you're going to pay that vendor.

- **Pay some of your smaller bills.**
  SCORE counselor Larry Lakin advises if you do get yourself in trouble, try and keep the pool of debtors as small as possible. So if possible, pay some of the smaller accounts. "You don't want your UPS guy to stop coming or your utilities shutting off."

- **Don't rob Peter to pay Paul.**
  If possible, avoid using money intended for one purpose to pay for something else – for example, avoid using money destined for taxes, to pay suppliers. "When deciding who to pay, you don't want to accrue more debt or liability," says Bill Ranganath.

- **The squeaky wheel doesn't always get the grease.**
  It's not necessarily a wise idea to move people to the top of your payment list just because they complain the most. You always need to be practical when assessing payments.

- **Don't avoid vendors.**
  Don't hide. Always talk to your vendors. Take their calls and provide them with consistent facts.

FUNDING OPTIONS

- Introduction
- Borrow or Invest
- Bank Loans
- SBA Loans
- Credit Cards

Introduction

KNOW YOUR FUNDING OPTIONS

Every business needs funding—money other than what it gets from customers. This money may be used to start the business, expand the business, or to smooth out temporary shortfalls. Funding comes from two sources: loans—usually from family, friends, or a bank; or investments—for example, by selling shares in your corporation or by granting someone a partnership interest. These two types of funding are known as debt and equity.

Debt or Equity?
Should you borrow money for your business or seek investors? And what should you consider before seeking funds from anyone?

Bank loans.
What does it really take to qualify for a bank loan? And more importantly, are you asking for enough money?

SBA loans.
How do you convince the Small Business Administration to guarantee a loan to your business?

Credit cards.
Credit cards guarantee you access to instant loans, instant payments , and incentive program advantages. Plastic funding may be the right choice for your small business.

Should You Borrow or Seek Investment?

WHAT IS BETTER: INCURRING DEBT OR LOSING OWNERSHIP?

Your first consideration for funding is whether you want to seek a loan or an investment. The advantage of a loan (debt) is that you are not giving up any ownership in your enterprise, and the lender has no management say or direct entitlement to profits in your business. Your only obligation to the lender is to repay the loan on time and you can deduct the interest payments at tax time. The disadvantage of a loan is the debt—the looming monthly payments and the potential for personal liability (if you guaranteed the loan), loss of property (if you secured the loan), or a lawsuit if you default on the loan payments.

The advantage of an investment (equity) is that you will not have to repay investors if your business goes under, and your personal property is unlikely to be at risk. The disadvantage is that you get a smaller piece of the pie because you are giving up a share of the business. And if an investor seeks to control your business, it may be more of a nuisance than a help.

LOOK TO FAMILY AND FRIENDS

Sometimes, your funding choices are made for you. For example, if you don't qualify or have enough resources to get a loan, then you need to find investors. The most common sequence for finding investment? (1) Look to your own resources, (2) look to family, and (3) look to friends. After exhausting those, look to an interested outsider.

Most likely, obtaining an investment will require some additional expenses incurred by your accountant and your lawyer. For example, if the investment is substantial, the investor may require that you convert your sole proprietorship to a corporation to shield the investor from personal liability.

WHY DO YOU NEED THE MONEY?

In general—whether you seek investors or lenders—you need to determine whether the money is needed for a temporary problem or a fundamental problem. Often, temporary problems can be resolved with a simple funding solution such as a merchant card account. But a fundamental problem—for example, lack of sales, too high cost of sales, too high administrative costs, too much inventory, too much accounts receivable—usually will not be cured by borrowing money says SCORE counselor Bill Ranganath. "In that case you need to address the fundamental problem and it's not a wise idea to borrow until you have done that."

How Do You Get a Bank Loan?

WHAT BANKERS WANT TO KNOW

Don't be misled by the conventional wisdom that you always need to provide a business plan to get a loan. SCORE counselor Bill Bunten, a veteran of over 30 years as a senior commercial bank manager, says, "Most of the loan applications that I've gotten are not accompanied by a business plan. When evaluating loans, usually bankers want the answers to five questions: (1) How much money do you want? (2) What is the money being used for? (3) How will you collateralize the loan? (4) When are you going to pay me back? and (5) How are you going to pay me back? Most borrowers will be able to tell you the answers to these questions in a conversation and if they can't … that's a red flag."

GOT COLLATERAL?

The other key element in getting a bank loan is understanding collateral. Collateral refers to the assets that you pledge for the repayment of a loan. These assets can be your business's accounts receivable, inventory, or business equipment and they are used to secure the loan (versus an "unsecured" loan which has no collateral). In the event you default on the loan, the lender can acquire and sell the collateral. If a business does not have any assets worth securing, a lender will look to personal assets—for example, stocks or bonds—or some other form of personal guarantee. A personal guarantee means that the borrower guarantees repayment from personal assets, rather than from business assets.

Getting ready to seek a loan? Consider these issues before handing in your application.

- **Be prepared to provide collateral or a personal guarantee.**
  Expect a request for either or both, especially if you're a first-time borrower. If you sign a guarantee, try and limit it to a one year guarantee that can be renewed if necessary. Avoid having your spouse sign a guarantee unless he or she is active in the business. If you have friends or relatives who are willing to guarantee your business loan but they're not willing to guarantee the whole loan, it could be because the guarantee requires them to be 'jointly and severally' liable, meaning they must pay the entire loan if there is a default. To avoid this result and to encourage multiple guarantors, SCORE counselor Bill Bunten suggests that sometimes, a guarantor can simply provide collateral for the portion of the loan they are guaranteeing. So if there are three guarantors, each may guarantee only one-third of the loan.

- **Ask for enough.**
  "One of the most common errors people make when borrowing is that they underestimate the situation and they borrow less money than they should," says SCORE counselor Bill Ranganath. "I had a client who makes wooden furniture and they do a great job and they're growing. They borrowed money from a bank and unfortunately they borrowed less money than necessary. When they went back to borrow more money, they found it was now more difficult because the bank was suspicious. Why hadn't they anticipated the right amount in the first place? And that made borrowing more difficult. By borrowing less than you need you haven't really solved the problem."

- **Establish your company's creditworthiness.**
  Here's one tip for building your company's creditworthiness from SCORE counselor Frank Wey: Don't use a personal credit card for business purposes. "That's the single rule that's violated most often. Most people have personal credit and they figure, well, we've got this card so why not use that to buy for the company. The problem is that it doesn't do a thing to help your business credit."

- **Know your credit history.**
  Do you have a checkered personal credit history? How long has your business operated? (Businesses under two years old tend to be viewed critically.). Do you know your credit score? You can't fix it if you

don't know what it is. (You can learn your credit score through services such as Dun & Bradstreet and Experian.)

- **Make sure your financials match up.**
  Don't provide financial reports that were printed at 3 a.m. the night before your meeting. Proof and review any financial documents used for a loan application with an accountant or financial advisor.

SBA Loans

THE GOVERNMENT GUARANTEES YOUR LOAN

If you're interested in a bank loan but you're not sure if you qualify or how to proceed, you may want to check out the Small Business Administration (SBA). The SBA does not make loans; it guarantees up to 85% of the amount you borrow from someone else in the event of default. Beware, though, despite SBA support, lenders sometimes require collateral or guarantees from the business owner for all (or a portion) of the loan. In other words, getting an SBA-guaranteed loan is often as difficult as getting a regular bank loan. To find out more, check out the SBA website (www.sba.gov). In addition, be prepared for the fact that SBA loans add another level of paperwork and fees to the loan application process.

WILL YOU USE A BROKER?

Should you use an SBA loan broker—a third party who facilitates the loan process? That depends. The broker may streamline the process but—since the broker may not be local—you may have a harder time resolving any problems, should they develop. SCORE counselor Bill Bunten cited the example of a business that contacted him for advice. Their SBA loan was in default and they wanted to talk to the lender to work things out. "The problem," says Bunten, "is that the lender was a broker, someone who was isolated geographically from them and they didn't have a personal relationship. Lacking that personal relationship—that face-to-face quality—made it difficult to solve the problem. Banking and lending is really about personal relations."

The SBA has an Express Loan process (under $25,000) that is usually granted based on personal qualifications. "Other than that," says Bunten, "you'll probably need a business plan to convince the lender that they want to partner with you. You don't need to provide a 35-page formal plan but your paperwork should tell them who you are, what you are, where you want to go, what's the financial forecast, and how you can pay the loan back."

Credit Cards

SPEED UP PAYMENTS AND EARN INCENTIVES

Small business use of credit cards has increased exponentially during the past decade and for good reason: credit cards provide short term access to cash to help with cash flow management and you earn value through incentive programs. (It's hard to argue with a funding solution that provides you with a free cell phone or computer.) At the same time, there's a potential downside to credit cards. As with all funding solutions, you need to borrow prudently and avoid burdening your business with high-interest debts. Some considerations to keep in mind when using credit cards:

- **Keep current.**
  You shouldn't use a card to borrow with if you can't stay current with your bills. Those perks may not seem as appealing as your debt mounts and you're chasing a high interest rate.

- **Pay attention to interest rates.**
  When shopping for a card, review competitive interest rates and be wary of teaser rates (low introductory rates that jump after a few months).

- **Don't borrow if your credit card balances are greater than 80% of your credit limits.**
  If they are, you've already got a credit card problem.

KNOW YOUR NUMBERS

- Introduction
- Accounting and Bookkeeping
- Accounting Principles
- Accounting Methods
- Keeping Records for the IRS
- Forecasting

Introduction

IDENTIFY, RECOGNIZE AND MAINTAIN

Bookkeeping—at least in terms of the IRS requirements—doesn't require that you hire an accountant or use bookkeeping software. As long as you can accurately state your income and expenses on your tax forms (and you've got the records necessary to prove that you're correct), you've satisfied the IRS.

But if you have employees, carry an inventory, have a large customer base, or incur substantial expenses, you need to institute standardized bookkeeping procedures, either on paper, or on a computer. Keeping good records will make your business more profitable by helping you:

- Identify every tax deduction you're entitled to take
- Recognize problems early (such as disappearing inventory, increased costs for products or equipment, or customers who aren't paying on time), before they have a chance to bring down your business
- Maintain your cash flow at acceptable levels
- Figure out whether it's time to raise (or lower) your prices
- Put together the financial reports you need to get loans and investment, and
- Prepare your tax returns quickly and accurately.

Accounting and bookkeeping.
Even if you're allergic to numbers, there's an accounting solution for your business.

Accounting principles.
Unfamiliar with accounting basics? Here's a short, painless primer.

Accounting methods.
Cash or accrual? Which is best for your business?

Keeping records for the IRS.
The IRS loves paperwork. Here's an explanation of what you'll need in the event of an audit.

Forecasting.
Forecasting your finances is part-mathematics and part-common sense. With a little patience you can master it.

Accounting and Bookkeeping

WHAT'S THE DIFFERENCE?

What's the difference between accounting and bookkeeping? Accounting is the process of managing and forecasting a business's finances. An accountant advises a business and prepares financial reports. Bookkeeping is part of the accounting program; it refers only to the recording and maintenance of your financial records. A bookkeeper inputs information and keeps your accounts up-to-date.

SOLUTIONS FOR NUMBER-PHOBICS

If you're an accounting novice and you've been dreading having to finally deal with business bookkeeping, don't worry. Even if you hid in the back of the algebra class, there are simple accounting solutions available to you. Here are three common approaches to bookkeeping.

- *I don't want to deal with numbers (except to periodically review financial information)*.
  Solution: Hire someone. If you're weak with numbers, too busy, or just don't want to think about it, hire a bookkeeper or accountant to handle your numbers. Go over your financials on a regular basis (monthly or quarterly) with your bookkeeper. By the way, accounting costs are tax deductible.

- *I want to handle some of it and use an accountant for other tasks*.
  Solution: Buy an accounting software program such as QuickBooks, Microsoft Accounting, or Peachtree Accounting. We'd recommend not installing the software yourself but instead have someone else install it—for example your bookkeeper, accountant or a qualified expert with knowledge of the specific program. That way you end up with the proper reports and charts customized for your accounts. These software programs also save you considerable time because you don't need to input credit card and banking information. Nowadays, banks and card providers allow you to download your financial data directly to your computer.

- *I want to handle all of it*.
  Solution: If you want to do it all, we'd recommend one of the accounting programs mentioned above or a customized software accounting solution created for your business. Since you will also be preparing your own taxes, we recommend that you use a tax program that integrates with your software.

What Accounting Principles do You Need to Know to Get Started?

YOU ONLY NEED TO KNOW THE BASICS

There's no escaping it. You will have to grasp a few basic accounting terms in order to manage your business efficiently. Here are the basics.

ASSETS AND LIABILITIES

Assets and liabilities are the Yin and Yang of your business. Assets are your "pluses," the things your business owns and is owed—for example, cash, real estate, inventory, accounts due, other property like patents or trademarks, and prepaid expenses—costs that are paid in advance such as taxes and insurance. Long-term assets such as buildings, equipment, or property that are not expected to be converted to cash are known as fixed assets.

Liabilities are your "minuses," the business obligations or things that are owed—for example tax payments, repayments to investors, money owed to banks. Also included in the liabilities column—although they're not actually liabilities—are owners' equity (the amount invested by the owners in the business).

WORK WITH A BALANCE SHEET

How do assets and liabilities apply to your business? Assets and liabilities figure into several financial reports, most prominently, the balance sheet—a snapshot of your business at a given time. A balance sheet is commonly required when you seek funding or loans. It also gives you a snapshot of your business at any particular moment—think of it as taking your business's blood pressure. If you use a software accounting program, generating a balance sheet is just a matter of a few mouse clicks. A balance sheet adds up the assets and liabilities in two separate columns. As the name implies, the columns must balance, that is they should equal each other. An example of a balance sheet is provided, below.

LOOKING AT A BALANCE SHEET

A balance sheet is a snapshot in the life of your business—just one financial moment preserved. It's one of several financial report cards that a business prepares. Sometimes it's referred to as a "Statement of Financial Condition." Below is a simple example of a balance sheet prepared for a bike rental service.

Bicycle Rental Shop Balance Sheet			
Assets		**Liabilities**	
$2,000	Money owed by customer (Accounts Receivable)	$4,000	Accounts Payable (Loan from parents)
$8,000	Inventory (40 bicycles)	$7,000	Equity (Investment by owner)
$1,000	Fixed Assets (bicycle racks and store fixtures)	$1000	Equity (Investment by uncle)
$500	Prepaid Expense (insurance payment)		
$500	Cash		
$12,000	TOTAL ASSETS	$12,000	TOTAL LIABILITIES

EQUITY AND DEBT

Outside of sales revenue, the two common ways that cash comes into a business are equity and debt — investments and loans. Equity is the money or property invested and retained in the business by the owners (also sometimes referred to as 'owners' equity'). If you don't properly track and account for equity, you will have tax problems and angry investors.

Debt—the loans, lines of credit and other borrowing you've done—refers to money that must be repaid usually with interest over a fixed period of time. If you don't properly manage debts the lender will foreclose on the loan, sometimes leading to a business bankruptcy.

ACCOUNTS RECEIVABLE AND ACCOUNTS PAYABLE

Accounts Receivable are amounts you are owed from sales of your products or services. Some retail businesses, since they receive payment immediately, have little or no accounts receivable. Accounts Payable are amounts you owe to vendors and suppliers, as well as any other short-term bills—for example payments for inventory, supplies or other goods or services. Loans and similar interest-bearing debts are not included in accounts payable.

Monitoring receivables and payables is a key element in cash flow management. As a general rule, your cash flow is stretched the longer you must wait for your accounts receivables. Conversely, you'll generally have less cash on hand if you pay bills (accounts payable) before they are due.

INCOME STATEMENTS

In order to avoid the mistake of looking at a payment and guessing at your profit, you should use an income statement. An income statement provides a line by line breakdown of revenue and the various sums that are subtracted from the revenue to determine profit. (Most accounting software programs will generate similar statements of profitability.)

The top line in an income statement is the total sales revenue (or "gross income"). That's followed by the sales costs—the direct costs involved in producing the items that are sold (also known as cost of goods sold, CGS or COGS). For example, if you are a book publisher, these costs might be the costs of paper and printing or the costs to pay a writer to create the book. When you deduct the cost of goods from total sales revenue you get the "gross profit."

GETTING TO YOUR OPERATING INCOME

The next lines are a series of operating expenses—for example: expenses associated with running your company, known as the general and administration costs (or "G&A"), and expenses associated with sales, marketing, and product development. When you subtract these operating expenses from your gross profit, you get your "operating income."

A company next subtracts interest on debt and arrives at an amount referred to as its "income before taxes." After taxes are subtracted, the income statement shows "net income from continuing operations," and then finally, after subtracting all its expenses listed above and any one-time losses (for example, a legal judgment) from its total sales revenue—the final number is considered the "net income."

CASH FLOW STATEMENTS

Some call it a cash flow statement, some call it a statement of cash flows and some just call it a cash statement, but no matter what it's called, the purpose is the same: to report your cash on hand and enable you to forecast your cash in the future.

A cash flow statement summarizes all the cash coming in and going out of a business during a specific period by analyzing cash in three classes: operations (sales and operating expenses), financing activities (loans and equity), and investing activities (ownership of real estate, securities and non-operating assets).

But is a cash flow statement really as helpful as it sounds? "Cash flow statements can be difficult to understand at first," says SCORE counselor Stanley Lakefish, "but once you have studied them, they become clearer. I know of several business people that have a hard time, but explanations from their accountant, each time, at least for a couple of accounting periods, really helps."

DECIPHERING CASH FLOW STATEMENTS

In other words, the challenge with cash flow statements—like many financial reports—is that they are troublesome to decipher. We recommend that you review monthly statements such as cash flow statements periodically with your bookkeeper or accountant. Once you understand how to read them you can efficiently get a pulse on the movement of cash, accounts receivable and bank balances.

You may find a cash flow projection (a document that helps you predict cash flow)—discussed later in this section—to be helpful as well.

Choose an Accounting Method

MOST BUSINESSES USE THE CASH METHOD

The IRS doesn't require all businesses to use a prescribed method, but it does require businesses to use a system that accurately reflects their income and expenses. The two basic ways to account for your income and expenses are the cash method and the accrual method, and some businesses use a hybrid.

The Cash Method.
Using the cash method, you record income when you actually receive it and expenses when you actually pay them. For example, if you complete a project in December 2008 but don't get paid until March 2009, you record the income in March 2009. Similarly, if you buy a digital camera for your business on credit, you record the expense not when you charge the camera and take it home, but when you pay the bill. (The IRS won't let you manipulate your income by, for example, not cashing a client's check until the next year; you must report income when it becomes available to you, not when you actually decide to deal with it.)

The Accrual Method.
Under the accrual method, you record income as you earn it, and expenses as you incur them. For example, if you complete a project in December 2008, that's when you record the income you expect to receive from it, no matter when the client actually gets around to paying you. (If the client never puts the check in the mail, you can eventually deduct the money as a bad debt.) And if you charge some furniture, you record the expense on the day of purchase, not when you pay the bill.

WHICH METHOD IS BEST?

So which method is better? It depends, of course. The cash method is much easier to use; most of us deal with our personal finances this way, so it's a system we're familiar with. It also gives you a clear picture of your actual cash on hand at any point in time. The accrual method can't tell you how much cash you've got, but it provides a more accurate picture of your business's overall financial health, particularly if your clients or customers are pretty good about paying their bills. It will show money that you've obligated yourself to pay, so you'll know that you can't count on using that money for other purposes. It will also show money you can look forward to receiving (again, if your customers pay you as promised).

As long as you make less than $1 million a year, you may choose whichever method seems right for your business. (If you've made more than $1 million in any of the last three tax years and your business carries an inventory, you might have to use the accrual method.) For more information, check out IRS Publications 334, Tax Guide for Small Business, and 538, Accounting Periods and Methods, both available at www.irs.gov.

Question: Which accounting system is used by most small businesses?

Answer: According to a 2006 NFIB Expenses Survey, 41% used the cash method, 17% used accrual, 13% used a hybrid, and a surprising 28% did not know what system they used (attributed to the fact that these owners did not have a "hands-on approach" to record keeping).

Keeping Records for the IRS

THE TAXMAN LIKES TO SEE RECEIPTS

If you face an audit, the IRS is not going to take your word for anything. You'll have to come up with receipts, cancelled checks, bank statements, and other records to support both the amount of income you claimed and any business deductions you took. You really can throw it all in a shoebox if you want, but most business owners find it easier to use a set of file folders or an accordion file (you can buy one that's already labeled with common business expense categories at an office supply store).

Don't expect the IRS to allow your tax deductions if you don't keep records to back them up. If you have no records at all, your deductions will be disallowed in an audit, and you might face penalties as well.

Question: Think you're an expert on small business taxes? How long should you maintain financial records in the event of an IRS audit?

Answer: In most situations, the IRS has up to three years to audit you after you file a tax return (or after the date when your tax return was due, if you filed early). However, if the IRS claims that you have unreported income exceeding 25% of the income you did report, it has six years to audit you. And if you didn't file a return or the IRS claims that your return was fraudulent, there is no audit deadline; you're always fair game. Based on these rules, some experts advise that you simply give up and keep all of your tax records forever. There's certainly no harm in keeping all of your actual tax returns forever; they don't take up much space and can help you track the financial life of your business over time. The supporting documents are another story. Unless you filed a fraudulent return (and this is something only you can decide), you can generally get rid of supporting documents six years after you file your tax returns.

Not sure what the IRS wants? Here is a checklist for IRS documents.

- **Income.**
  To document income, you'll need copies of your bank statements, copies of checks you've deposited, copies of any 1099s you received, and, if you have nontaxable income, copies of documents showing

the source of that income (for example, from an inheritance). Remember, the IRS is less interested in the business income you reported than in the income it thinks you failed to report. This means your job is not really to prove the amount of income your business earned, but to prove that any income you didn't report came from a nontaxable source.

- **Business expenses.**
  To document most business expenses, you must keep records showing what you bought, who you bought it from, how much you paid, and the date of the purchase. In most cases, you can prove this with your receipt and a cancelled check or credit card statement (which proves that the receipt is really yours).

- **Vehicle expenses.**
  To document vehicle expenses, you must keep records of the dates of all business trips, your destination, the business purpose of your trip (for example, to meet with a client or scout a retail location), and your mileage.

- **Meals and entertainment.**
  To document meals and entertainment, you must keep records of what you paid for, who you bought it from, how much you paid, the date of purchase, who you were with, and the business purpose of your meeting. The first four facts are often included on a receipt; the remaining two you can record in a date book or calendar or on the receipt itself.

- **Use of property.**
  To document your use of property, you must keep records of how much time you spent using it for business and using it for other purposes. This rule applies to "listed property," items that the IRS believes people often use for personal purposes, including computers and cameras. (There really is a list of listed property, and you can find it in IRS Publication 946, How to Depreciate Property.) You might also want to keep track of the time you spend in your home office, to prove that you use it regularly. You can keep these records in a log or journal.

What is Forecasting?

YOU CAN SEE YOUR FINANCIAL FUTURE

Financial forecasting helps you predict the cost of your products or services, the amount of sales revenue, and profit you can anticipate. If your business is not already off the ground, financial forecasting will explain how much you'll have to invest or borrow.

Obviously, financial forecasting depends on your type of business—that is, whether you are a retail business, service business, manufacturing or wholesale business, or a project development business (that's a business like real estate rehabilitation in which you work on one house at a time.)

FINANCIAL HISTORY HELPS

Forecasting is always easier if you've been in business for a little while, because you have months (or years) of actual revenue and expenses upon which to base your forecasts. If you haven't got any history this section can help you get started.

Don't be intimidated. Financial forecasting is not so bad. It's a matter of making educated guesses as to how much money you'll take in and how much you'll need to spend—and then using these estimates to calculate how and when your business will be profitable.

Here are the financial projections you should make:

THE BREAK-EVEN ANALYSIS

This analysis tells you how much revenue you'll need each week or month to break even. To calculate it, you need to make two estimates:

- **Fixed costs.**
  Also known as overhead, these costs usually include rent, insurance, and other regular, set expenses. (Loan repayments and the costs you pay for any goods you will resell are not fixed costs.)

- **Gross profit percentage.**
  Start with your gross profit—what's left after you deduct the direct costs for each sale. For example, if you paid $150 for a bicycle and sold it for $250, your gross profit is $100. In order to determine your gross profit percentage, you divide your profit by the selling price—in this case 40% ($100/250).

To calculate your break-even, divide your monthly overhead expenses by your profit percentage (as a decimal). For example, if your bicycle shop has fixed monthly costs of $4,000, and your profit percentage is 40%, then you need sales of $10,000 a month to break even ($4,000 divided by .40). In terms of the bike store, if you were selling bicycles at $250 a bicycle, you would need to sell 40 bikes a month to break even. If this amount is below your anticipated sales revenue, then you're facing a loss—and you'll need to lower expenses or increase sales to break even.

THE PROFIT AND LOSS FORECAST

In your profit and loss forecast (or P&L), you refine the sales and expense estimates that you used for your break-even analysis, into a formal, month-by-month projection of your business's profit for one or two years of operation. It's basically a spreadsheet that details your expected expenses and revenue on a month-by-month basis. For example, you plug in estimates of monthly revenue and of phone service, depreciation, shipping, and other expenses. SCORE Counselor Charles Christiansen adds, "I happen to be a strong advocate of forecasting dollars for all line items but also including the percentage each one is of the Gross Sales/Revenue line which is always 100%. It is a very good management tool as it allows very quick assessment of the relationship of 'forecast numbers' to 'actual results' when reviewing any P&L statement. Percentages keep one focused whereas fluctuation of dollar numbers can lead to misleading and confusing conclusions.

CASH FLOW PROJECTION

Your cash flow projection focuses on day-to-day operations and tries to help you predict whether you can survive those in-between times when you must pay bills but there is no revenue. For example, the cash flow for the first few months of a business is often negative. In order to survive, you may need to borrow money during that period. Cash flow projections are useful for every business, but they're particularly helpful if you have not yet opened.

To make your cash flow projection you'll have to prepare a spending plan, setting out items your business needs to buy, and expenses you will need to pay. You then feed these numbers, along with information from your profit and loss forecast, into a spreadsheet. You'll need to determine and add in details such as whether you will be making credit sales and how much time is granted—for example, you grant 90 days to pay a bill (Net 90) on your invoices. That helps determine when you can expect payments.

WHAT ARE RATIOS AND WHY DO THEY MATTER?

Reports and forecasts are great but they don't tell you how well you are doing in relation to other businesses within your industry. For example, is it healthy or unhealthy if your nail salon's total debt equals your total assets? Since companies come in different shapes and sizes, the best way to make comparisons is by using ratios—comparisons of different elements from your balance sheet.

RATIOS: THE CHALLENGE

"The challenge with ratios," says SCORE counselor Frank Wey, "is that there's got to be some standard. If you discover your tap water is all brown and you have your well tested, and they report that you have magnesium at 47 parts per million, you don't know what you've got unless you can measure it against a standard. The same is true for ratios."

Wey, a credit consultant and expert on analyzing financial statements created a universal ratio standard for manufacturers and wholesalers and suggests that business owners review the standards for other industries created and popularized by Robert Morris and Associates (known as "RMA Standards") "Deviation can be good or bad," says Frank Wey. "If there's bad deviation you want to look into the reasons and adjust accordingly."

Ratios are commonly expressed as a percentage (usually x divided by y) or simply as "x:y." (Although, as Wey points out, many people have difficulty with ratios and find it easier to calculate them in dollars and cents.) At the end of each accounting period, you should review and calculate certain ratios. Wey recommends using four benchmark ratios:

CURRENT RATIO (ALSO KNOWN AS "ACID-TEST RATIO")

This measures how well your business can pay off short-term debts (or as it is sometimes referred to, the size of your "buffer" or "cushion"). It's determined by dividing current assets by current liabilities. For example, if your current assets total $100,000 and your current liabilities total $50,000, the current ratio is expressed as a healthy 2 (or 2:1) ratio. (That is, you have $2.00 in current assets for each $1.00 in current debt.) If you paid off $40,000 of the current liabilities so that it was $60,000 in current assets and $10,000 in current liabilities, your current ratio would improve to 6 (or 6:1). If on the other hand, if you had $50,000 in assets and $100,000 in debt, you would have a risky ratio of .5 (or 1:2).

QUICK RATIO

Like your current ratio, the quick ratio measures your company's ability to pay outstanding liabilities. The difference is that the quick ratio analyzes the amount of cash (or assets that can be quickly converted to cash) that can be used to pay off liabilities. For that reason you determine the quick ratio by subtracting inventory from current assets, then dividing the result by current liabilities. (You subtract the inventory because that cannot be quickly converted to cash.) Therefore if you had current assets of $100,000, current liabilities of $50,000, and inventory of $50,000, the quick ratio is expressed as a 'good' 1 (or 1:1).

DEBT TO EQUITY RATIO (D/E)

This ratio is calculated by dividing the total debt (liabilities) by the total shareholder equity in the company. This ratio measures risk to current or future creditors—the higher the ratio, the greater the risk for the business (and for a lender). Ideally, your company's debts should not exceed the amount invested into it. For example, if your business's total debt is $110,000 and your shareholder equity is $95,000; your debt to worth ratio is 1.157. If that ratio were to rise dramatically—for example debt rose to $250,000 making the ratio 2.63, it's a signal that your company could be having a problem (or is headed for one) and should hold off on incurring more debt.

PROFIT WORTH

In addition to the other four ratios, another ratio which you may find helpful is your profit margin. This is the calculation that matters the most to many business owners because it makes clear how much of each dollar in sales ultimately becomes profit. It's a percentage calculated by dividing net income for any period by the net sales from that period. That is, it tells you how much of your profit is being eaten by your expenses. For example, if your appliance store netted $100,000 on sales of $1 million during the last twelve months, your profit margin is 10%.

PUTTING IT TOGETHER

- Your 3-Day Cash Flow Review

Your 3-Day Cash Flow Review

YOUR MONTHLY CHECKLIST

Here is a list of cash-flow questions to consider on a monthly basis.

- **Are your accounts receivables late?**
  When people are not paying you in a timely manner, you'll always be short of cash. Are you reluctant to approach your customers? Are you accepting credit and debit cards payments? Read more about getting paid quickly.

- **Is your inventory turning slowly?**
  Inventory is cash transformed into products. So when you're holding lots of unsold inventory you're really preventing access to cash. In addition, inventory costs create a financial burden. It's often best to sell inventory at break-even prices (or even incur a loss) rather than have it take up space without generating revenue. For more on inventory, read monitoring inventory.

- **Are you controlling expenses?**
  It may seem obvious, but your failure to control costs can be a major factor for cash flow problems. Learn more about minimizing expenses. Have you prepared a budget? If not, you should do so with the aid of your accountant. Once you've got that in place, avoid deviating from it.

- **Is your business undercapitalized?**
  Many SCORE counselors remarked that under-capitalization is a leading cause of negative cash flow. Should you borrow or seek more investment? Learn more about funding.

- **Are you hitting budget targets?**
  Preparing a monthly or quarterly budget is essential to business success. You may not always stick to it, but your budget provides a road map for avoiding cash flow problems. Software programs such as QuickBooks, Microsoft Accounting, or Peachtree Accounting, are designed to help you prepare budgets.

- **Are you periodically reviewing payroll expenses?**
  If business is down, it may be time to review your payroll and consider outsourcing or hiring temps. We discuss the pros and cons of contractors and employees.

- **Are you paying bills before they're due?**
  Sometimes there can be benefits to paying your bills early—for example, you may qualify for a discount—but if not, there are more benefits to waiting, for example, 30 days, and then paying the bill. Even better, in terms of holding on to your cash, is to get longer terms for paying back your suppliers.

The continued success of your business will trigger more questions about cash flow and financing. The more you learn, the better you'll be able to respond, and the stronger your business will become. You'll find more help and expert advice at the Visa Business Network at VisaBusinessNetwork.com, or by contacting a SCORE counselor at SCORE.org