



GETTING A  
**HANDLE**  
ON SMALL-  
BUSINESS  
**FINANCE**

FUNDAMENTALS OF SMALL-BUSINESS FINANCE

MAKING INFORMED  
CHOICES FOR  
YOUR BUSINESS



# GETTING A **HANDLE** ON SMALL- BUSINESS **FINANCE**



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**Y**ou have a revolutionary product. You know your target market. Your funding is in place. And you're a whiz at public relations. How could your new business possibly fail?

Unfortunately, the creative and marketing sides of your business persona can't guarantee success for your company. No matter how good you are at your core business, you'll end up hanging out the "closed" sign for good if you don't manage the money that flows in and out of your accounts. Knowing something about small-business finance is as crucial to your longevity as a great product and eager customers. Far too many entrepreneurs realize too late in the process that they

should have paid closer attention to their businesses' "financials" from day one.

As chief of the finance division in the San Francisco district office of the Small Business Administration (SBA), Ray Monahan sees firsthand just what can happen to a business when an owner doesn't have a handle

**YOU CAN'T LEAVE THE  
FINANCIAL MANAGEMENT  
OF YOUR BUSINESS  
TO LENDERS AND ACCOUNTANTS.**

on his or her business finances.

"Without a thorough understanding of your business financials and the key reports and measures that tell you where you stand, you simply can't know what you need to succeed, what you have the capacity to accomplish, or how to avoid financial problems," says Monahan.

To illustrate what can happen when a business isn't run with a close eye on the numbers, Monahan recalls a shoe store owner coming into the SBA for help with financing. Convinced that he needed more money to expand his inventory, the shop owner was all set to apply for long-term financing. After some in-depth analysis, the business's financial reports revealed that what the owner really needed was some assistance to better manage his inventory. Not using the available financial tools

nearly put this shopkeeper on the line for a big loan.

In this example, the business got back on track thanks to some timely expert advice from the SBA, but no business owner can leave the fate of his or her venture up to luck or good timing. The fact is, while you can hire consultants and services to

handle everything from human resources to IT (information technology), you can't leave the financial management of your business to lenders and accountants. Financial profes-

sionals are there to serve as resources —to provide technical expertise and help with more complex tasks, such as filing your annual tax return—not to make the financial decisions for your business. No one wants your company to succeed more than you do, which makes you uniquely qualified to manage its finances.

Before you start worrying about what that entails, realize that getting a handle on your business finances doesn't mean you have to go out and earn a master's degree in business administration (MBA). It does, however, require learning basic financial accounting principles, doing some research, getting comfortable with accounting software, and implementing practices and procedures that will get you organized and keep you on track. □

# ORGANIZING YOUR FINANCES



**O**nce you open your doors for business, you'll need to turn your attention to generating cash flow, staying solvent, and making a profit. The way to achieve these three goals is to run your business by the numbers. That means knowing your books inside and out and making business decisions accordingly.

## **YOUR BUSINESS BUDGET**

No business plan is complete without a budget. If you hope to receive a credit union, bank, or government loan or outside investments to start your business, you'll need a business plan and a budget. A well thought out budget helps convince a loan officer that you know your business and have a realistic plan for making money and paying debts. If you didn't need outside funding to get your venture off the ground, you may have been able to skate by without a budget, but that doesn't mean you should continue gliding

forward without one now.

"When you're working for someone else, you can plan on getting the same paycheck every pay period," says Monahan. "When you're running a business, you have to plan for inconsistency. The best way to do that is with a budget."

Your budget should be more than just a hopeful prediction. It should make reasonable forecasts based on experience, industry benchmarks, and market research. Taking a conservative approach will help you avoid expensive mistakes, like signing leases and buying supplies and equipment you can't afford.

If your company is very small, you can get by with one general budget for all areas of your business. If, however, you have different departments, multiple products, and a staff of managers, you'll need to break down the all-inclusive company budget into smaller departmental budgets. Your managers can use these to set sales goals, plan for capital improvements, and control expenses in their areas. If you've ever worked for a larger company and had a manager tell you, "Sorry, it's not in the budget," you know how effective budgets can be at controlling unplanned purchases.

While some businesses draw up an annual budget, the reality is that you need to manage the budget all year long. Waiting until year's end to determine that you're overspending or underearning means you've been operating for as long as 12 months



with a problem that wasn't being addressed. By then, your business may be beyond salvaging. When you draw up your annual fiscal budget, break it down into more manageable time

frames—weeks, months, and quarters—so you'll see much sooner if you're on track or not.

A budget is simple in theory. Essentially it boils down to income (sales revenue + capital from investment and credit) and expenses. Be safe—and conservative. Estimate on the low side for income and on the high side for expenses. Expenses include all your costs from raw materials, equipment, payroll, advertising, taxes, and administrative costs.

The goal of budgeting is to keep your company in the black. The beauty of a budget is that if you input all your projected income and expenses and the bottom line reveals that you're going to end up in the red, you can re-script the outcome by reducing expenses (for example, by

## **ACCURATE FINANCIAL RECORDS WILL KEEP YOU FROM LOSING SLEEP.**

hiring fewer employees or purchasing less expensive computers) and increasing income (say, by focusing more resources on sales and marketing).

Budgeting is a

tool to manage your business.

Creating an accurate budget improves with time and experience. After a few years in business, you'll be able to project income and expenses based on history. While new business owners don't have past performance to go on, projecting income and expenses isn't an exercise in futility. While you may not have "actuals" for many of the budget categories, a little research can go a long way toward filling in the blanks. For example, trade groups and industry reports, discussions with business owners in your field, guidance from SBA consultants and accountants, and input from vendors all can contribute to your creating as realistic and accurate a budget as possible.

One key element is calculating your

break-even point (p. 21) so you'll have a clear understanding of your minimum sales target needed to cover your expenses—including your desired draw—before you even start your business.

## RECORD KEEPING

Record keeping is simply tracking and documenting financial transactions on a routine basis. The effect could be immediate, as when a cus-

### MAKE GOOD HABITS

Once you know what records you should keep, make the process part of your routine:

- Every day, record your sales, payments, credit union or bank deposits and withdrawals, and inventory changes. Update your checking register accordingly.
- Weekly, or at least biweekly, review your accounts receivable and contact past-due customers. Compile your accounts payable and pay bills that are due; take advantage of any early payment discounts offered. Pay any payroll taxes due.
- At month's end, reconcile your bank statements. Enter all financial activity for the month, and total all accounts. Reconcile petty cash, making sure that the cash remaining and the receipts combined equal the starting balance.
- Depending on the tax year you go by (calendar or fiscal) and what month it is, you also may have to file your federal and state estimated quarterly tax returns. If you sell a taxable product and the state has put you on a monthly or quarterly, rather than annual, filing schedule, complete your sales tax report and include a check for the tax you've collected.
- Run your reports, including your income statement (which reflects sales, expenses, and profit or loss for the period), balance sheet (which compares assets and liabilities) and cash-flow statement (which shows your cash activity and ending balance). See pp. 16 and 17 for these descriptions.
- At the end of the fiscal year, close your books—in other words, total all your transactions and run your year-end reports. Do the same at the end of the calendar year, and send out 1099 forms, which provide the IRS information about miscellaneous payments (for example, payments of more than \$600 that you've made to independent contractors during the year), and W-2 forms, which report wage and tax information for employees. Prepare to meet with your accountant—or to file your own income tax return—by gathering reports, forms, and receipts.

Staying on top of your books is a much underrated strategy for success. The quicker you get the data into your accounting system, the greater the likelihood it will be accurate, and the sooner you'll be able to run reports and make decisions. Your books will signal where to focus your efforts, how to invest your capital, or when to cut expenses. Once you understand what records are crucial to maintain and you have a procedure for gathering them, you'll turn your record-keeping responsibilities into a smooth and efficient process.



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customer writes you a check to purchase your product, or it may be delayed, as when you sign a lease for office space. Accurate financial records will help you compile key financial statements, get financing, prepare your tax returns, and make better-informed business decisions. Despite the time it takes to keep thorough books, you'll actually save hours because you won't have to recreate all your transactions when you get audited or need to apply for a loan.

Step one in keeping accurate records is to separate your business finances from your personal finances. That means having a separate business checking account and business credit card. Do not pay personal expenses with business funds or business credit.

Your business checking (sometimes called a share draft) account is a very important part of your record-keeping system. It simplifies things if you process as many of your transactions through it as possible. Deposit all receipts in your business checking account and make all

payments by check or online from this account.

It's not enough to simply record your transactions. You also must keep supporting documentation, such as deposit slips, receipts, charge slips, invoices, canceled checks, cash register tapes, bank statements, tax forms, employee payroll records, and 1099 forms (miscellaneous payments made to you or by you). IRS (Internal Revenue Service) Publication 463, Travel, Entertainment, Gift and Car Expenses, is a great reference