

Know Your Numbers

Unlocking Financial Success for Small Businesses

**Presented by the Northland Small Business
Development Center**



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Business Accounting

Income Statement and Balance Sheet

- Types of Accounts and where they belong
- Relationship between the two statements
- What information each statement tells you

Break Even

- How to calculate the zero point
- How to use the BE with additional projects like buying a piece of equipment or hiring an employee

Margin and Markup

- Define the difference between the two ways of determining sales price.
- Why margin will give you more profit

Ratios and Benchmarking

- What is a ratio
- What they are used to measure
- How do we benchmark industry standards

Finding Cash in Your Business.

- The role of inventory
- How A/R can affect your cash

Banking Relationship

- Line of Credit (LOC) rules of thumb
- What is the LOC used for
- Equity down for a loan
- SBA Loan types: 504, 7a, Express PLP Lender
- Bank Checklist

Cash Flow Projections

- Work on an actual cash flow budget

The Income Statement and Balance Sheet

Balance Sheet: The balance sheet is a snapshot of a company's financial position at a specific point in time, typically at the end of a fiscal quarter or year. It provides a summary of a company's assets, liabilities, and equity. The key components of a balance sheet include:

- **Assets:** These are what a company owns and can be categorized as current assets (e.g., cash, accounts receivable) and non-current assets (e.g., property, plant, equipment). Assets represent what the company possesses, which can generate future economic benefits.
- **Liabilities:** These are what a company owes to external parties. They can be current liabilities (e.g., short-term debt) or non-current liabilities (e.g., long-term loans). Liabilities represent the company's obligations to repay debts and fulfill other commitments.
- **Equity:** Equity represents the residual interest in the assets of the entity after deducting liabilities. It is also known as shareholders' equity and reflects the owners' stake in the company.
- **Profit and Loss Statement (Income Statement):** The profit and loss statement provides a summary of a company's revenues, expenses, gains, and losses over a specific period, typically a fiscal quarter or year. It reveals whether the company has generated a profit or incurred a loss during that time. Key components of an income statement include:
 - **Revenue (Sales):** This is the total amount of money earned by the company from its primary operations. It is often referred to as sales or turnover.
 - **Expenses:** These are the costs incurred in the process of generating revenue. Expenses can include operating expenses (e.g., salaries, rent, utilities), cost of goods sold (COGS), interest expenses, and taxes.
 - **Gains and Losses:** These are non-operating items that can either increase (gains) or decrease (losses) the company's net income. Examples include gains from the sale of assets or losses from discontinued operations.

The relationship between the balance sheet and the profit and loss statement is captured by the fundamental accounting equation:

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

This equation illustrates that a company's assets are funded by either debt (liabilities) or the owners' investment (equity). The income statement influences the balance sheet in the following ways:

- **Net Income:** The net income from the income statement flows into the balance sheet and increases equity. If a company generates a profit, it adds to its equity, strengthening its financial position.

- *Dividends*: If a company distributes dividends to shareholders, it reduces its equity, as this represents a return of earnings to the owners.
- *Retained Earnings*: Net income that is not distributed as dividends is typically retained by the company and becomes part of its equity as retained earnings.

In summary, the balance sheet and profit and loss statement are interconnected, with the income statement influencing changes in equity on the balance sheet. Together, they provide a comprehensive view of a company's financial performance and position, helping investors, analysts, and stakeholders assess its overall health and sustainability.

What goes on an income statement vs. a balance sheet?

The income statement and the balance sheet report on different accounting metrics related to a business's financial position. By getting to know the purpose of each of the reports you can better understand how they differ from one another.

Income Statement

What goes on an income statement? An income statement, also called a profit and loss statement, lists a business's revenues, expenses and overall profit or loss for a specific period of time. An income statement reports the following line items:

- **Sales**: Revenue generated from the sale of goods and services
- **Cost of Goods Sold**: Including labor and material costs
- **Gross Profit**: The cost of goods sold subtracted from sales
- **General and Administrative Expenses**: Includes rent, utilities, salary, etc.
- **Earnings Before Tax**: Your business's pre-tax income
- **Net Income**: The total revenue minus total expenses, which gives the profit or loss
- The end goal of the income statement is to show a business's net income for a specific reporting period. If the net income is a positive number, the business reports a profit. If it's a negative number, the business reports a loss.

[Video: What is an Income Statement?](#)

Balance Sheet

A balance sheet format can be broken down into two main sections – assets on one side, and liabilities and equities on the other. These sections will need to be recorded in a balanced format, meaning when an entry is inserted in one column, a corresponding entry will be made in the other column.

A balance sheet reports a business's assets, liabilities, and equity at a specific point in time. A balance sheet is broken into two main sections: assets on one side and liabilities and equities on the other side. The balance sheet formats require the two sides balance out, meaning they must be equal to one another. It reports the following line items:

- *Current Assets*: Assets that will be converted to cash within a year, including accounts receivable, inventory, and prepaid expenses
- *Long-Term Assets*: Assets that won't be converted to cash within a year, including land, buildings, and equipment
- *Current Liabilities*: Debts owed within a year, including rent, utilities, taxes, and payroll
- *Long-Term Liabilities*: Long-term business loans, pension fund liabilities
- *Shareholders Equity*: A business's net assets, including money generated by the business and donated capital
- *Amortization Expenses*: These are also called depreciation expenses, and account for any long-term assets over the life span of their use (such as cars or expensive technology)
- *Account Balances*: The amount of money that is in your financial accounts at any given time, after debits and credits have been accounted for. This includes any long term saving accounts or checking accounts.

The balance sheet tells you what your business owns and what it owes to others on a specific date. It gives a snapshot of the business's overall worth.

Video: What is a Balance Sheet?

Balance Sheet

Assets

Cash

Accounts Receivable

Inventory

Prepaid Expenses

Fixed Assets

(Accumulated Depreciation)

Intangible Assets

Liabilities and Owners' Equity

Accounts Payable

Accrued Expenses Payable

Notes Payable

Owners' Equity - Invested Capital

Owners' Equity - Retained Earnings

Income Statement

Sales Revenue

Cost of Goods Sold Expense

Depreciation Expense

Amortization Expense

Operating Expenses

Interest Income

Income Tax Expense

Net Income

Profit & Loss Statement XYZ Company													
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	Year Total
Sales													
Products	1,000	1,000	1,000	1,000	1,000	3,000	2,500	1,500	4,000	1,000	1,000	1,000	\$ 19,000
Services	500	500	500	500	500	500	500	500	500	500	500	500	\$ 6,000
Total Sales	1,500	1,500	1,500	1,500	1,500	3,500	3,000	2,000	4,500	1,500	1,500	1,500	\$ 25,000
Cost of Goods Sold	300	300	300	300	300	300	300	300	300	300	300	300	\$ 3,600
Gross Profit	1,200	1,200	1,200	1,200	1,200	3,200	2,700	1,700	4,200	1,200	1,200	1,200	\$ 21,400
Expenses													
Advertising	50	50	50	50	50	50	50	50	50	50	50	50	\$ 600
Accounting													\$ -
Bad Debts													\$ -
Bank Charges													\$ -
Car Rental													\$ -
Cell Phone / Land Line	100	100	100	100	100	100	100	100	100	100	100	100	\$ 1,200
Cleaning													\$ -
Commissions													\$ -
Consulting													\$ -
Contract Labor													\$ -
Credit Card Fees													\$ -
Donations													\$ -
Dues & Subscriptions													\$ -
Education													\$ -
Employee Benefits													\$ -
Freight													\$ -
Garbage	50	50	50	50	50	50	50	50	50	50	50	50	\$ 600
Gas (Vehicle)													\$ -
Insurance													\$ -
Internet	50	50	50	50	50	50	50	50	50	50	50	50	\$ 600
Inventory Purchases													\$ -
Loan Interest	604	603	602	601	600	599	598	597	596	595	594	593	\$ 7,182
Office Supplies	20	20	20	20	20	20	20	20	20	20	20	20	\$ 240
Outside Services													\$ -
Payroll Hourly													\$ -
Payroll Salary	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	\$ 12,000
Payroll Taxes (12%)	120	120	120	120	120	120	120	120	120	120	120	120	\$ 1,440
Parking													\$ -
Postage													\$ -
Printing													\$ -
Real Estate Taxes													\$ -
Refunds													\$ -
Rent/Lease	300	300	300	300	300	300	300	300	300	300	300	300	\$ 3,600
Repairs/Maintenance													\$ -
Research & Development													\$ -
Security System													\$ -
Shop Supplies	25	25	25	25	25	25	25	25	25	25	25	25	\$ 300
Snow Plowing													\$ -
Tools													\$ -
Travel													\$ -
Utilities	300	300	300	300	300	300	300	300	300	300	300	300	\$ 3,600
Other													\$ -
Total Expenses	\$ 2,619	\$ 2,618	\$ 2,617	\$ 2,616	\$ 2,615	\$ 2,614	\$ 2,613	\$ 2,612	\$ 2,611	\$ 2,610	\$ 2,609	\$ 2,608	\$ 31,362
Net Profit	\$ (1,419)	\$ (1,418)	\$ (1,417)	\$ (1,416)	\$ (1,415)	\$ 586	\$ 87	\$ (912)	\$ 1,589	\$ (1,410)	\$ (1,409)	\$ (1,408)	\$ (9,962)

Balance Sheet XYZ Company		
	As of December 31	
CURRENT ASSETS		
Cash	\$	2,000.00
Accounts Receivable	\$	5,000.00
Notes Receivable	\$	-
Inventory	\$	16,000.00
Other Current Assets		
TOTAL CURRENT ASSETS	\$	23,000.00
FIXED ASSETS		
Equipment/Land/Buildings	\$	25,000.00
Less: Accumulated Depreciation	\$	(3,000.00)
TOTAL FIXED ASSETS	\$	22,000.00
OTHER ASSETS		
Marketable Securities (Long-Term)		
Intangibles (Start-Up Costs/Goodwill/Etc.)		
Less: Accumulated Amortization		
TOTAL OTHER ASSETS	\$	-
TOTAL ASSETS	\$	45,000.00
CURRENT LIABILITIES		
Current Portion of Long-Term Debt		
Note Payable - Bank (LOC)	\$	11,000.00
Note Payable - Other		
Accrued Payroll Liabilities		
Accrued Sales Tax Liabilities		
Income Taxes Payable		
Other Current Liabilities		
Accounts Payable	\$	3,000.00
TOTAL CURRENT LIABILITIES	\$	14,000.00
LONG TERM LIABILITIES		
Bank Loan 1	\$	20,000.00
Bank Loan 2		
Bank Loan 3		
Existing Loans		
Subordinated Officer Debt		
TOTAL LONG TERM LIABILITIES	\$	20,000.00
TOTAL LIABILITIES	\$	34,000.00
OWNER'S EQUITY		
Capital Stock/Owner's Equity	\$	1,000.00
Paid-In Capital	\$	10,000.00
Owner Distributions		
Retained Earnings		
TOTAL OWNER'S EQUITY	\$	11,000.00
TOTAL LIABILITIES & EQUITY	\$	45,000.00

Break-Even

Break-Even is when you have zero profit or loss. Understanding this and being able to calculate Sales required to get to break-even will help you to determine how much sales you need to cover increases in expenses.

Break-even analysis is a crucial financial concept used to determine the point at which a business neither makes a profit nor incurs a loss. It's a valuable tool for understanding the financial viability of a product, project, or business endeavor. Break-even analysis is primarily associated with cost and revenue information and is typically used to make informed decisions about pricing, production, and overall business strategy.

Break-Even Point: The break-even point is the level of sales or revenue at which total costs (both fixed and variable) are exactly equal to total revenue, resulting in zero profit or loss. In other words, it's the level of output or sales volume where a business covers all its expenses but doesn't generate any profit.

Key Components for Break-Even Analysis:

- *Fixed Costs (FC)*: Fixed costs are expenses that remain constant regardless of the level of production or sales. They include items like rent, salaries, insurance, and depreciation. Fixed costs do not change with fluctuations in production or sales volume.
- *Variable Costs (VC)*: Variable costs are expenses that vary in direct proportion to changes in production or sales volume. Examples include raw materials, labor directly tied to production, and commissions on sales.
- *Total Costs (TC)*: Total costs are the sum of fixed and variable costs. It represents the total expenses incurred by a business at a given level of production or sales.
- *Total Revenue (TR)*: Total revenue is the income generated from selling products or services. It is calculated by multiplying the selling price per unit by the number of units sold.

The calculation is:

Fixed Costs divided by Gross Profit Margin percentage equals Break-Even.

$$\text{FC/Gross Profit Margin \%} = \text{BE}$$

Total Operating Expenses are the Fixed Costs. Here are key points about operating expenses:

1. Nature of Operating Expenses:

- **Routine Costs:** Operating expenses are regular, recurring costs that a business faces in its normal course of operations.
- **Non-Production Costs:** Unlike the cost of goods sold (COGS), which represents the direct costs of producing goods or services, operating expenses relate to the supporting activities necessary to keep the business running.

2. Types of Operating Expenses:

- Examples: Common operating expenses include salaries and wages, rent, utilities, insurance, office supplies, marketing and advertising expenses, maintenance costs, legal and accounting fees, and depreciation of assets used in operations.
- Variability: Operating expenses can be categorized as either fixed (e.g., rent, salaries) or variable (e.g., utilities, office supplies). Fixed expenses remain relatively constant, while variable expenses may fluctuate with changes in business activity.

3. Importance of Operating Expenses:

- Profitability Assessment: Operating expenses are subtracted from a company's revenue on the income statement to calculate operating profit (also known as operating income or EBIT - earnings before interest and taxes).
- Investor and Lender Analysis: Investors, lenders, and analysts closely examine a company's operating expenses to assess its financial performance and sustainability. A significant increase in operating expenses without a corresponding increase in revenue can raise concerns.

4. Impact on Profitability:

- Operating Profit: Operating expenses have a direct impact on a company's operating profit. Higher expenses reduce operating profit, while lower expenses increase it.
- Net Profit: After accounting for interest, taxes, and non-operating items, operating profit contributes to a company's net profit, which is the bottom-line profit or net income.

5. Managing Operating Expenses:

- Cost Control: Effective management of operating expenses is vital for maximizing profitability. Businesses often seek ways to control and reduce operating costs without compromising quality or customer service.
- Budgeting: Budgeting and forecasting operating expenses help businesses plan for future financial needs and set performance goals.

6. Reporting and Analysis:

- Income Statement: Operating expenses are typically presented on a company's income statement, where they are deducted from total revenue to calculate operating profit.
- Trend Analysis: Companies analyze trends in their operating expenses over time to identify areas for improvement or cost-saving opportunities.

In summary, operating expenses encompass the ongoing costs associated with a business's regular operations. These expenses are crucial for assessing a company's financial performance, profitability, and sustainability. Effective management of operating expenses is essential for maintaining a healthy bottom line and achieving long-term success.

Contribution Margin

Contribution margin is a financial metric that plays a key role in understanding the profitability of individual products, services, or business segments. It represents the portion of a company's revenue that is available to cover fixed costs and contribute to the company's net profit after covering variable costs. Contribution margin is a valuable tool for making pricing decisions, assessing product profitability, and guiding resource allocation. Here's a detailed explanation of contribution margin:

Contribution Margin Formula: The contribution margin is calculated using the following formula:

$$\text{Contribution Margin} = \text{Revenue} - \text{Variable Costs}$$

1. Understanding the components:

- **Revenue:** The top-line revenue represents the total income generated from sales.
- **Variable Costs:** These costs include expenses such as direct materials, direct labor, and variable overhead directly tied to the production or sale of a product or service.

2. Interpretation of Contribution Margin:

- **Positive Contribution Margin:** A positive contribution margin indicates that the product or service is generating more revenue than its variable costs, contributing to covering fixed costs and potentially generating profit.
- **Negative Contribution Margin:** A negative contribution margin means that the product or service's variable costs exceed its revenue, which can lead to losses that need to be covered by other products or business segments.

3. Use Cases for Contribution Margin:

- **Pricing Decisions:** Businesses can use contribution margin to determine appropriate pricing strategies. Products or services with higher contribution margins can support lower prices, while those with lower contribution margins may require higher prices to maintain profitability.
- **Product Line Analysis:** It helps businesses assess the profitability of different product lines or individual products. By comparing contribution margins, companies can identify which products contribute most to their overall profit.
- **Cost Control:** Understanding variable costs is essential for cost control efforts. Businesses can analyze and attempt to reduce variable costs to increase contribution margins.
- **Break-Even Analysis:** Contribution margin is a critical component in break-even analysis. It helps determine the sales volume needed to cover both variable and fixed costs, resulting in a break-even point.

4. Contribution Margin vs. Gross Margin:

- **Gross Margin:** Gross margin represents the difference between revenue and the cost of goods sold (COGS). It focuses solely on the direct costs of producing goods, while contribution margin considers variable costs beyond COGS, such as sales and marketing expenses.

5. Contribution Margin and Fixed Costs:

- After covering variable costs, the contribution margin is used to contribute to covering fixed costs (e.g., rent, salaries, utilities). Any remaining contribution margin contributes to net profit.

In summary, contribution margin is a valuable financial metric that helps businesses assess the profitability of products, services, or business segments. It provides insights into how much revenue is available to cover fixed costs and generate profit after accounting for variable costs. By understanding contribution margin, businesses can make informed pricing decisions, improve profitability, and allocate resources effectively.

Profit & Loss Statement XYZ Company		
Sales	Year Total	Percent of Sales
Products	\$ 19,000	
Services	\$ 6,000	
Total Sales	\$ 25,000	100%
Cost of Goods Sold	\$ 3,600	14%
Gross Profit	\$ 21,400	86%
Expenses		
Advertising	\$ -	
Accounting		
Bad Debts		
Bank Charges		
Car Rental		
Cell Phone / Land Line	\$ 1,200	5%
Cleaning		0%
Commissions		0%
Consulting		0%
Contract Labor		0%
Credit Card Fees		0%
Donations		0%
Dues & Subscriptions		0%
Education		0%
Employee Benefits		0%
Freight		0%
Garbage	\$ 600	17%
Gas (Vehicle)		0%
Insurance		0%
Internet	\$ 600	2%
Inventory Purchases		0%
Loan Interest	\$ 7,182	29%
Office Supplies	\$ 240	7%
Outside Services		0%
Payroll Hourly	\$ 12,000	48%
Payroll Salary		0%
Payroll Taxes (12%)	\$ 1,440	6%
Parking		0%
Postage		0%
Printing		0%
Real Estate Taxes		0%
Refunds		0%
Rent/Lease	\$ 3,600	14%
Repairs/Maintenance		0%
Research & Development		0%
Security System		0%
Shop Supplies	\$ 300	1%
Snow Plowing		0%
Tools		0%
Travel		0%
Utilities	\$ 3,600	14%
Other		0%
Total Expenses	\$ 31,362	125%
Net Profit	\$ (9,962)	-40%

If we take the Total Expenses number of \$31,362 and divide it by the Gross Profit Margin of 0.856

\$31,362 / 0.856 = \$36,637 is the Sales needed to Break Even

***Proving it Works
\$36,637 – \$25,000 (current SALES) = \$11,637 INCREASE IN SALES to Break Even***

\$11,637 * 0.856 = \$9,962 loss

If rent for XYZ Company goes up by \$2,000 per year, how much do Fixed Costs and Break Even Sales change?

Let's illustrate the concept of break-even with a simple example:

Scenario: Imagine you're starting a small business that manufactures and sells handcrafted wooden tables. You've estimated your initial costs and variable costs per table and set a selling price for your tables. Your goal is to determine at what level of sales you will break even, meaning your total revenue equals your total costs, resulting in zero profit or loss.

Key Assumptions:

- Fixed Costs (monthly): \$2,000 (rent, utilities, insurance, etc.)
- Variable Cost per Table: \$50 (includes materials and direct labor)
- Selling Price per Table: \$150

Calculating the Break-Even Point based on number of units:

Fixed Cost / (Selling Price per Unit - Variable Cost per Unit) = Break-Even (in units)

Substituting the values, $\$2,000 / (\$150 - \$50) = 20$ units

Interpretation: Your break-even point is 20 units. This means you need to sell 20 tables to cover all your costs (fixed and variable) and reach a point where your total revenue equals your total costs. Below this level of sales, you would incur a loss; above it, you would generate a profit.

Profitability Analysis:

- If you sell fewer than 20 tables in a month, you would operate at a loss because your revenue would be less than your total costs.
- If you sell exactly 20 tables, your revenue would be \$3,000 (20 tables x \$150 each), and your costs would be \$2,000 in fixed costs and \$1,000 in variable costs (20 tables x \$50 each), resulting in zero profit or loss.
- If you sell more than 20 tables, your revenue would exceed your total costs, and you would start making a profit.

This break-even analysis provides you with a clear understanding of the level of sales you need to achieve to cover your costs and avoid losses in your table-making business. Beyond the break-even point, each table you sell contributes to your profit.

Margin versus Markup

In the context of selling products for a business, margin and markup are two important concepts that help determine pricing and profitability.

Margin refers to the difference between the cost of a product and its selling price, expressed as a percentage. It represents the portion of revenue that exceeds the cost of goods sold (COGS) and other expenses. Margin is calculated using the formula:

$$\text{Margin} = (\text{Selling Price} - \text{Cost}) / \text{Selling Price} * 100\%$$

Markup, on the other hand, is the percentage by which the cost price of a product is increased to determine its selling price. It reflects the proportion of profit added to the cost of the product. Markup is calculated using the formula:

$$\text{Markup} = (\text{Selling Price} - \text{Cost}) / \text{Cost} * 100\%$$

Lets say you have determined you need to make **26%** on the products you sell to obtain a high enough gross profit to pay the expenses and yourself.

You purchase a widget for \$4.00. You decide to multiply the \$4.00 by **1.26** to incorporate 26% profit, and you get a sale price of \$5.04. Will this give you the desired **26%** you want?

If you sell 1 widget for \$5.04 and the cost is \$4.00 you will have made \$1.04 in profit. This is called markup.

Now lets' change how we decide on a selling price. Using the same \$4.00 cost we will figure selling price based on margin instead of markup. Take the **26%** you want to make and subtract it from 100%. You get 74% or 0.74 converted to decimal.

Now take the \$4.00 cost and divide by 0.74 and you get a selling price of \$5.41.

You have now made \$1.41 in profit as opposed to \$1.04., an increase of \$0.37 cents per widget.

If we go back and look at the margin for the \$5.04 price.
\$1.04 profit divided by \$5.04 will give us \$.026 or 2.6 % margin versus the 26% margin.

Video: What's the Difference Between Gross Margin vs Gross Markup?

Ratios and Benchmarking

A ratio is a calculation and method of looking at your numbers. We develop ratios to compare your company with industry benchmarks for companies like yours. We use the NAICS codes or North American Industry Classification System to compare similar companies.

Video: Financial Ratio Analysis

Common Ratios for business financial analysis are as follows:

Ratio	Formula	Significance
Balance Sheet Ratios		
Current	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$	Measures Solvency: e.g. a ratio of 1.76 means that for every \$1 of current liabilities, the Co. has \$1.76 in Current Assets with which to pay
Quick	$\frac{(\text{Cash} + \text{Accts Rec})}{\text{Current Liabilities}}$	Measures Liquidity: e.g. a ratio of 1.14 means that for every \$1 of current liabilities, the Co. has \$1.14 in Cash & AR with which
Net Margin	$\frac{\text{Net Profit Before Tax}}{\text{Sales}}$	Measures Net Profitability: e.g. a ratio of 2.9% means that for every \$1 of sales, the Co. produces 2.9 cents of gross profit
Specific Efficiency Ratios		
Inventory Turnover	$\frac{\text{Cost of Goods Sold}}{\text{Inventory}}$	Measures the Rate at Which Inventory is Being Used on an Annual Basis: e.g. a ratio of 9.81 means that the average dollar volume of inventory is used up almost ten times during the fiscal year
Inventory Turn-Days	$\frac{360}{\text{Inventory Turnover}}$	Measures the Average Number of Days that Inventory Remains in Stock: e.g. a ratio of 37 means that the Co. keeps an average of 37 days worth of inventory on hand throughout the year.
Accts. Rec. Turnover	$\frac{\text{Sales}}{\text{Accts. Rec.}}$	Measures the Rate at Which Accts. Rec. are Being Collected: e.g. a ratio of 8.00 means that the average dollar volume of Accts. Rec. are collected 8 times during the year
Avg. Collection Period	$\frac{360}{\text{Accts. Rec. Turnover}}$	Measures the Average Number of Days that the Co. Must Wait for Its Accts. Rec. to be Paid: e.g. a ratio of 45 means that it takes the 45 days on average to collect its receivables
Accts. Pay. Turnover	$\frac{\text{Cost of Goods Sold}}{\text{Accts. Pay.}}$	Measures the Rate at Which Accts. Pay. Are Being Paid: e.g. a ratio of 12.04 means that the average dollar volume of Accts. Pay. are paid about 12 times during the year
Avg. Payment Period	$\frac{360}{\text{Accts. Pay. Turnover}}$	Measures the Average Number of Days that a Co. Takes to Pay its Accts. Pay.: e.g. a ratio of 30 means that it takes the Co. 30 days on average to pay its bills

Class example: calculate the current ratio, the quick ratio, and the net margin ratio for Company XYZ (reference the Balance Sheet on Page 7 and the Profit & Loss Statement on Page 6).

Finding Cash in Your Business

Inventory although a very important component of product-based companies is also a very important component in the company's cash situation. You need to look at every piece of inventory as actual dollars sitting on the shelf.

If you have an item that cost you \$20.00 and it has been sitting on your shelf for 2 years, that is \$20.00 that could have been in your checking account and available to pay debt, payroll, and other business expenses - or even cash distribution to you.

Not enough inventory and you run out of stock and customers are not happy. Too much inventory and you are lacking cash because it is sitting on the shelf.

Your inventory level can be measured in many ways. One way is to look at the ratio of how many times your inventory turns during a year or quarter or month. The more turns the faster your inventory is being depleted and replenished.

Inventory Turnover	$\frac{\text{Cost of Goods Sold}}{\text{Inventory}}$	Measures the Rate at Which Inventory is Being Used on an Annual Basis: e.g. a ratio of 9.81 means that the average dollar volume of inventory is used up almost ten times during the fiscal year
Inventory Turn-Days	$\frac{360}{\text{Inventory Turnover}}$	Measures the Average Number of Days that Inventory Remains in Stock: e.g. a ratio of 37 means that the Co. keeps an average of 37

Class example: Calculate Inventory Turnover and Inventory Turn Days for Company XYZ.

A second way to find cash in your business is to look at accounts receivable and how long it is taking your customers to pay you. Again, if you are not being paid on time you will need to borrow or look for cash to put into the business.

Accts. Rec. Turnover	$\frac{\text{Sales}}{\text{Accts. Rec.}}$	Measures the Rate at Which Accts. Rec. are Being Collected: e.g. a ratio of 8.00 means that the average dollar volume of Accts. Rec. are collected 8 times during the year
Avg. Collection Period	$\frac{360}{\text{Accts. Rec. Turnover}}$	Measures the Average Number of Days that the Co. Must Wait for Its Accts. Rec. to be Paid: e.g. a ratio of 45 means that it takes the 45 days on average to collect its receivables

Class example: Calculate Accounts Receivable Turnover and Average Collection Period for XYZ Company.

Banking Relationship

Develop a relationship with your bank and or banker. Always be honest and open about the financial position of your company. Provide them with the information they want on a timely basis. They will be more responsive to someone who is upfront with them.

Line of Credit

An LOC or Line of Credit is used as short-term borrowing to purchase inventory or pay for new employees. A Line of Credit should never be used to purchase fixed assets such as equipment, buildings, and renovations. It is understood that a LOC is to be at zero borrowed for 30 days of a calendar year. Those 30 days do not have to be consecutive.

If you need to purchase inventory in September for sales in November and December this would be a good use of a LOC. If you are hiring a new employee and sales are expected to go up as a result of that hire this would also be good use of a LOC.

General guidelines when borrowing

A bank likes to see 20% or better of owner equity when looking at financing a project. If you want to purchase \$100,000 of equipment the bank would like to see you put down \$20,000, and they finance \$80,000 of the total amount. This is not written in concrete but is generally the case. There are all kinds of different scenarios which can change the assumption.

Types of Loans

Conventional Loans

The bank makes the credit decision and is solely responsible for the loan. This is usually the least expensive lending with less fees and lower interest rate.

SBA Loans

SBA loans, or Small Business Administration loans, are financial assistance programs offered by the United States Small Business Administration (SBA) to help small businesses access funding for various purposes, including startup capital, working capital, equipment purchases, and more. The SBA doesn't directly lend money to small businesses but partners with banks, credit unions, and other financial institutions to provide loan guarantees, reducing the risk for lenders and making it easier for small businesses to secure loans.

Types of SBA Loans:

- **7(a) Loan Program:** The most common SBA loan program, the 7(a) program, offers loans for various business purposes, including working capital, equipment purchase, expansion, and more. The bank receives a guarantee of 75% to 85% of the loan amount.
- **504 Loan Program:** This program is designed to provide financing for purchasing real estate, machinery, and other fixed assets. This loan is split up between the bank and a Community Development lender. The bank lends 50% of the loan and the other lender lends 40% therefore the borrower equity is only 10%. This is for an existing business. If it is a start-up business the percentages change to 50% bank, 35% Community lender, and 15% equity for the borrower. These types of loans make good sense for projects not needing working capital. Owner equity requirements vary for special use buildings.
- **Microloan Program:** Microloans are smaller loans (up to \$50,000) targeted at startup businesses and small businesses in need of short-term working capital.
- **SBA Express Loans:** This is similar to an SBA 7(a) loan except the lender only gets a 50% guarantee if the loan defaults. There is also less paperwork that the bank must file. SBA Express loans generally can be originated more quickly than through the 7(a) program.
- **Disaster Loans:** The SBA provides disaster loans to businesses affected by natural disasters, such as hurricanes or floods.

Benefits of SBA Loans:

- **Lower Interest Rates:** SBA loans often offer lower interest rates compared to conventional loans, making them more affordable for small businesses.
- **Longer Repayment Terms:** SBA loans typically have longer repayment terms, which can help lower monthly payments and improve cash flow.
- **Lower Down Payments:** SBA loans often require smaller down payments, making it easier for businesses to access funding with less capital upfront.
- **Flexible Use of Funds:** Depending on the loan program, SBA loans can be used for various business purposes, providing flexibility to business owners.

Eligibility and Application:

- Eligibility criteria for SBA loans vary depending on the specific loan program and lender. Generally, small businesses that meet size standards defined by the SBA, have a sound business purpose, and demonstrate the ability to repay the loan are eligible.
- To apply for an SBA loan, business owners typically need to work with an SBA-approved lender. The application process involves submitting financial documents, a business plan, and other relevant information.

SBA Loan Guarantees:

- SBA loans are considered less risky for lenders because the SBA guarantees a portion of the loan amount. If the borrower defaults, the SBA pays the guaranteed portion to the lender, reducing the lender's losses.

Loan Terms and Amounts:

- Loan terms and amounts vary based on the specific loan program and the purpose of the loan. For example, 7(a) loans can be as large as \$5 million with repayment terms ranging from 7 to 25 years, depending on the use of the funds.

Repayment:

- Borrowers are typically required to make regular payments to repay the loan, including principal and interest. SBA loans may have fixed or variable interest rates, depending on the loan program and lender.

Use of Funds:

- The use of funds can vary depending on the loan program but may include working capital, purchasing equipment, real estate acquisition, debt refinancing, and more. Specific restrictions and allowable uses are determined by the loan program guidelines.

The SBA steps in and gives the bank a guarantee from 75% to 90% of the loan value if the loan defaults. There are fees associated with this and they are passed on to the customer.

The loan still has to pass financial scrutiny. In essence the SBA is giving the bank an insurance policy in case of default. SBA loans take more time to process usually 90 days as opposed to a conventional loan. They do, however, give the bank a green light to make the loan where without the guarantee, the bank would not lend.

In summary, SBA loans are government-backed financial products designed to help small businesses access funding and support their growth and development. These loans offer favorable terms and lower risk for lenders, making them an attractive financing option for small business owners. However, eligibility requirements, loan terms, and the application process can vary, so it's important for small business owners to work with SBA-approved lenders and understand the specific details of the loan program they are interested in.

Bank Loan Checklist

This is an example of the items required for a bank loan.

1. Business Plan
2. Sources & Uses
3. Current Business Debt Schedule (Existing Businesses Only)
4. Three Years Company Tax Returns & Financial Statements
5. Company In-House Interim Statements for year to date
6. Three Years Projections, Cash Flow & Assumptions
7. Copy of the Purchase Agreement
8. List of Collateral & Estimated Values
9. Personal Financial Statement (All 20% Owners)
10. Three Years Personal Tax Returns (All 20% Owners)
11. Personal Resume (All 20% Owners)
12. Affiliated Company Information (All 20% Owners)
13. Franchise Agreement (If Applicable)
14. Company Articles, By-Laws & Registration Documents
15. Copy of Drivers Licenses & List of Previous Gov't Loans (For SBA Loans)
16. Copy of Leases (If Applicable)

Cash Flow Projections

We talked about profit and loss statements and balance sheets, now lets take a look at a cash flow statement that will calculate how much cash a business might have. We will project how much cash will be on hand over a 6 month period.

Class example: Complete Cash Flow Projection for ABC Widgets.

Starting Cash: \$2,000

Accounts Receivable Terms: 30 days

Sales by Month:
December \$5,000
January \$3,000
February \$3,000
March \$4,000
April \$5,000
May \$9,500
June \$9,000

Expenses	Jan	Feb	March	April	May	June
Advertising	\$50	\$50	\$50	\$50	\$50	\$50
Cell Phone	\$150	\$150	\$150	\$150	\$150	\$150
Loan Payments	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000
Payroll	\$1,000	\$1,000	\$1,500	\$1,500	\$2,000	\$3,000
Snow Plowing	\$500	\$500	\$500	\$400	\$100	\$0
Inventory Purchase	\$300	\$300	\$500	\$1,000	\$2,000	\$2,000

Cash Flow Year 1	JAN	FEB	MAR	APR	MAY	JUN		Total
Starting Cash								Profit & Loss
Sales								
Total Cash Available								
Cash Paid Out								
Advertising								
Accounting								
Cell Phone / Land Line								
Consulting								
Credit Card Fees								
Garbage								
Gas (Vehicle)								
Insurance								
Internet								
Loan Payments (P&I)								
Office Supplies								
Payroll								
Payroll Taxes (12%)								
Real Estate Taxes								
Rent/Lease								
Repairs/ Maintenance								
Shop Supplies								
Snow Plowing								
Utilities								
Subtotal								
Purchases/ Inventory								
Owner Pay								
Total Cash Paid Out							Total Expenses	
Cash (end of month)							Net Profit	

Cash Flow Year 1	JAN	FEB	MAR	APR	MAY	JUN		Total
Starting Cash	\$2,000	\$1,000	\$ -	(\$700)	(\$800)	\$2,400		Profit & Loss
Sales	\$3,000	\$3,000	\$4,000	\$5,000	\$9,500	\$9,000		\$33,500
Total Cash Available	\$5,000	\$4,000	\$4,000	\$4,300	\$8,700	\$11,400		
Cash Paid Out								
Advertising	\$50	\$50	\$50	\$50	\$50	\$50		\$300
Accounting								
Cell Phone / Land Line	\$150	\$150	\$150	\$150	\$150	\$150		\$900
Consulting								
Credit Card Fees								
Garbage								
Gas (Vehicle)								
Insurance								
Internet								
Loan Payments (P&I)	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000		\$12,000
Office Supplies								
Payroll	\$1,000	\$1,000	\$1,500	\$1,500	\$2,000	\$3,000		\$10,000
Payroll Taxes (12%)								
Real Estate Taxes								
Rent/Lease								
Repairs/ Maintenance								
Shop Supplies								
Snow Plowing	\$500	\$500	\$500	\$400	\$100	\$0		\$2,000
Utilities								
Subtotal	\$3,700	\$3,700	\$4,200	\$4,100	\$4,300	\$5,200		\$25,200
Purchases/ Inventory	\$300	\$300	\$500	\$1,000	\$2,000	\$2,000		\$6,100
Owner Pay								
Total Cash Paid Out	\$4,000	\$4,000	\$4,700	\$5,100	\$6,300	\$7,200	Total Expenses	\$31,300
Cash (end of month)	\$3,000	\$2,000	\$300	(\$800)	(\$2,100)	\$200	Net Profit	\$2,200