Ask Andi
Trusted Advisor to Business Owners

Time for a Mid-Year Check Up on Finances

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Want to be sure that we show a profit this year. Know we can't have both high profit and low taxes. Where is the balance? Need to be sure to show the bank improvement over 2012. What stats should we be watching?

Thoughts of the Day: Building a successful company means that it is growing both revenue and profitability. Focus on building reserves and getting ratio improvements when comparing assets, liabilities and equity. As long as your company needs to borrow money, think of the bank as a partner who needs to be kept informed.

When managing in a downturn, it's essential to have an accurate picture of where the company is headed – immediately and mid-term. Define any shortfall, rather than ignoring the problem, by comparing revenue forecast to expense budget. Do everything possible to reduce the shortfall to zero by cutting expenses and focusing on profitable revenue. Identify use of lines of credit and other debt instruments to close any gaps. Figure out ahead of time if the company risks running out of cash. Be realistic.

While the finance department is usually focused on reporting on historical performance, and keeping controls in place, its greatest value comes from creating a go-forward picture. Planning out the forecast of revenue and building an accurate expense budget is a way of showing everyone where the company is going, in financial terms.

Set revenue targets that everyone can agree on. Don't over or under forecast. Use the budget to plan out critical expenditures needed to boost sales and marketing, in order to get the company back on track for profitable growth.

Look at crucial ratios that will determine whether or not the company can obtain additional financing. Compare current assets (cash, accounts receivable, inventory) to current liabilities (accounts payable, lines of credit, current year's portion of long term debt). The ratio needs to be 2:1 or higher.

Next take a look at debt: equity ratio. That needs to be under 2.5: 1. Companies with the greatest difficulty meeting that ratio tend to be young, under capitalized firms, and companies that have been taking losses for a long time.

If the company is at or above 2.5, and there are no funds available from the owners, the company is going to have to make do with what it has available. It may also be at risk of having it's lines called by the bank. Treat this situation very seriously by building a plan to boost profits and sales immediately, without taking on additional debt.

Many times the debt: equity ratio is okay, but the current assets: current liabilities ratio is too low. If that is the case, consider terming out some of the credit line, thereby moving debt out of current liabilities, into long term. This move won't impact the debt: equity ratio, but it will improve the ca: cl ratio.

Once the company starts to produce profits, use the money to pay down debt and build reserves at the same time. $1goes to debt service, $1 into cash reserves. Building up cash reserves will give the company more room to manoeuver than paying down debt alone.

If the company is struggling, keep the bank informed. Banks don't like surprises. They want to see an owner who is knowledgeable, forthright, and working to solve problems with the resources available. Demonstrate that by sharing plans and reporting with timely data.

Ask the bank to meet with you, to review existing reports. Ask for their suggestions. What additional reports do they think you should be looking at? What ratios would they like to see? How often? They can be helpful, if you open the door to a cooperative relationship, and they may see things that you don't. The best part: their advice is usually part of the package of services they offer, you might as well make use of it.

Looking for a good book? Never Run Out of Cash, The 10 Cash Flow Rules You Can't Afford to Ignore, by Philip Campbell.

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