

Eight Keys to Financial Success

A firm financial foundation frees you to grow your business

As your business continues to grow, you need to keep an eye on your financial picture. It's easy for a simple business that essentially operates from a checking account to quickly transition to one that requires a full accounting system, handling everything from accounts receivable, depreciable assets, workforce payroll taxes and other financial obligations. All of these move the financial complexity to another level. Here are some items to keep your eye on in order to achieve solid financial performance.

1. Keep Tabs on Cash Flow

Watch your cash flow. That advice can't be stressed enough. Although you may celebrate landing that big order, if you do not receive any income while ramping up your operations to fulfill the order, you'll find yourself dealing with a cash flow crisis.

A cash flow statement is easy to generate. Make a habit of reviewing it at least monthly. Purchasing materials and resources while cash is delayed coming in creates a "lead-lag" effect. To counter it, you need to have more money in the bank to pay for the cash-in delay.

2. Understand Your Financial Documents

In addition to the cash flow statement, learn how to read other financial reports such as your P&L statements. Financial reports are basic working documents, and you cannot let their apparent complexity blind you to asking questions and knowing what the numbers represent. Good accountants and advisors will help you interpret the figures, so you can clearly see the financial picture of your business.

3. Know Your True Liabilities

Some business owners make the mistake of overlooking quarterly or annual payments in their monthly financial reviews. This, of course, distorts the company's true financial picture. For example, payroll taxes are a liability that you might only have to pay on a quarterly basis, but you need to recognize this liability monthly in order to have a clearer picture of your financial position. Insurance premiums are another good example of a payment you may not make monthly but which you must nonetheless record as a liability.

4. Know the True Cost of Your Product

You cannot place a competitive price on your products if you do not know their true costs. Be sure to include the costs of labor, storage and overhead in your calculations. Just looking at materials and shipping masks the real cost of the product.

Also factor in what it costs to sell the product. It is essential to calculate the cost of advertising, promotional materials, trade shows and other marketing efforts. Without calculating these costs, you won't arrive at an accurate price for your product.

5. Determine Profit Margins

Gross profit margins are calculated by dividing your total sales into your gross profit. If your gross profit margin is staying consistent or trending upward, you are probably on track to achieve your profit

goals. However, declining margins are an excellent initial signal that you need to review your costs, pricing and other aspects of your business.

6. Deal With Debt

Debt is a normal part of most businesses. But you need to monitor it in light of the assets of your business. How do you know when your outstanding loans are too high? By regularly calculating a debt-to-asset ratio, you can monitor changes over time and make sure your debt is not getting out of control. The smaller the ratio the better.

7. Monitor Accounts Receivable

Accounts receivable sometimes give business owners a false sense of confidence. Some owners make the inaccurate assumption that they will collect 100 percent of the dollars owed to the business. The truth is, particularly in difficult economic times, some accounts receivable will need to be handled by collection agencies for a fee and some will need to be written off the books as uncollectable.

8. Control Accounts Payable

Accounts payable is the other side of the coin. Sometimes business owners manage them to help their cash flow situation. Although slow payment of your bills will allow you to keep higher cash reserves in the bank, it will create difficult relationships with your suppliers. Even worse, slow payment may create the impression that you are a financially troubled firm—never a good situation when you are growing and needing more deliveries on credit.

By taking the time to address these eight keys on a regular basis, you can be more confident about the financial health of your firm. Then you can focus more of your attention on acquiring new customers and growing your business.

By Richard Delaney