Financial Management

Know Your Business Numbers

Today, I want to start with this question. What do Richard Branson, Walt Disney, Coco Chanel, Henry Ford, and Milton Hershey all have in common?

The answer is that they all created business empires without earning a high school diploma and they were great with numbers! Granted in some cases they got help early on to assist them with business accounting.

So my message here is that 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. If this is not one of your key skill sets, seek help ASAP.

This is a follow-up to last week’s column where I applied the “Knowledge is King” saying and reminded business owners that all business decisions are financial decisions. 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.

So what types of numbers do you need to know? For starters, 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.

If you're looking for help managing your numbers, seek out a SCORE mentor as a starter. They can help you get a grip on managing your cash flow. In addition to face to face mentoring they also provide workshops and a variety of related topics.

If you already feel you have a good handle on this for your business, let me test that by sharing with you a real life example. Warren (name is changed) was a SCORE client recently. His business 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 September and his supplier makes him an offer that's hard to refuse. He can order 400,000 wooden roses in September at $.25 per rose instead of his usual rate of $.50 a rose. But he doesn't have $100,000 in September to pay the vendor for the roses. What should he do?

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 Warren’s SCORE mentor, Wally Nigbur.
What are the sales conditions?

According to Nigbur, the first issue is whether Warren can sell this volume of wooden roses. "He may have sold 200,000 roses in one year, 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 September through January," says Nigbur, "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, 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," Nigbur reminds Warren, "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 percent 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.

How did you do? 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.

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