For Your Business Success
...understand revenues and expenses

Keeping with my 2019 challenge to every small business CEO (“get your business in order this year”) I will give some basic suggestions for understanding revenues and expenses.

One of the main goals of any business is to drive revenue. That said, new business owners may not fully realize the importance of tracking their revenue in detail, along with the money their business spends.

Not every business owner is an accounting expert, but a little knowledge can go a long way when it comes to tracking revenue and expenses.

Every person who starts a business does so with the intention of making money. The only way to determine if your business is successful in that context is to diligently track your revenue and expenses.

Tracking them shows your bottom line, which indicates the current financial health of your business. That’s the single most important reason to stay on top of your revenue and expenses.

In addition, keeping your books updated allows you to view trends and helps you forecast the future. For example, the owner of a small hamburger stand that has been open for three years might notice that revenue is very high during the summer months but cools off significantly during the holidays. If there is a clear and consistent pattern, this can help the owner make smart decisions, such as adding staff to maximize profits in the summer or shortening business hours in the winter to cut down on costs.

Finally, keeping good financial records saves you stress and anxiety when tax season rolls around. Rather than scrambling to make sense of how much money your business made and spent the previous year, you’ll have peace of mind knowing your financial records are current and accurate.

Jose Borrero, Vice President & Chief Financial Officer, Small Business Services, Deluxe Corp (one of SCORE’s content business partners) put it this way. “It’s important to keep track of all the revenue you bring in but keeping tabs on your expenses is equally important — if not more so. It gives you a clear picture of your spending habits and where you might need to make cuts, if necessary.”
What do you need to do this? Here are the two best tools to use:

1. **Balance sheet:** A balance sheet is one of the most important financial statements your business will deal with. It provides an overview of where your business stands financially, showing you what you own and what you owe. A detailed balance sheet helps you determine the overall financial strength of your business.

2. **Profit and loss statement:** Also known as an income statement, a profit and loss statement shows your income coming in (revenue), and your costs going out (expenses). It analyzes how your business performs over a set amount of time, such as a month, quarter or year.

**Know these few terms:** When tracking your revenue and expenses, a number of terms pop up frequently. Below are some important ones to know.

- **Revenue:** This is the money your business brings in during an accounting period. Revenue is often referred to as your “top line,” because it’s the first item listed on a profit and loss statement.

- **Expenses:** The opposite of revenue, expenses are what your business spends money on. Subtracting your expenses from your revenue shows your business’s bottom line, which is your net income or net profit.

- **Return on investment (ROI):** Your ROI is the amount of money your business makes (return) compared to how much it spent (investment). It’s often shown as a percentage. For example, if you spent $1,000 on a marketing campaign and it led to an additional $5,000 in sales, the return on investment is $4,000, or 400 percent.

- **Margin:** This term is short for profit margin, a measure of how much money your business makes. There are two forms of this:

  - **Gross profit margin** is the profit you made before the cost of goods or services is subtracted from revenue. For example, if you bought a T-shirt from your supplier for $5 and sold it to a customer for $12, your gross profit margin is $7.

  - **Net profit margin** is the profit you have after accounting for all of your expenses and costs. In the same T-shirt example, assume you spent an additional $5 in expenses related to acquiring, inventorying, marketing and selling the shirt. Your net profit margin, then, is $2 ($12 sale, minus $5 to acquire the shirt, minus an additional $5 to cover labor and expenses). Your net profit margin is the best way to determine if your business is making or losing money.
For service businesses, calculate gross margin by subtracting the hourly labor cost of the person providing the service from the price of the service. For example, if a plumber on your staff earns $75 an hour, and spends one hour fixing a broken pipe that you charge $200 to repair, your gross profit margin is $125. To calculate your net profit margin, factor in the cost of parts, supplies and operational expenses related to this broken pipe repair.

When tracking revenue and expenses for your business, you will most likely come across some or all of these types of accounts:

1. **Cash**: Each of the transactions your business makes passes through the cash account. Put another way, this account tracks when your business makes or receives a payment.

2. **Inventory**: If you sell any type of goods, inventory refers to the products or materials you have in stock.

3. **Accounts payable**: This is the money that is sent from your business, typically to cover bills.

4. **Accounts receivable**: Conversely, this refers to the money your business brings in, specifically when you sell something and don’t receive an immediate payment.

5. **Payroll**: Your payroll is the money you pay to all of your employees and yourself.

6. **Sales**: Another fairly straightforward account, this tracks the revenue you bring in from selling your products or services.

7. **Purchases**: The opposite of sales, purchases are any of the materials or goods that you buy for the business.

8. **Loans payable**: This is where you track the money you’ve borrowed to fund your business, including how much is owed and when it’s due.

9. **Owners’ equity**: This account refers to the amount of money each owner has put into the business.

10. **Retained earnings**: Retained earnings track any profits that are reinvested into the business and not paid out to owners. This is a great tool to gauge how your business has performed since you opened your doors.
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