Five Things Every Small Business Owner Should Know About Their Business

A million details to keep track of. A thousand documents to read. What's most important if you want your business to succeed? Here is the list that gets my vote for the 5 most important financial questions. Notice we ask the questions but we don't provide the answers, because none of these are "one answer fits all" questions. The right answer is the one that you look at and say to yourself: "Great answer!" So, here's my list:

1. How much profit do you really make on each of your 10 largest customers?

Why? Because the profit you make on those big customers (top 10 or top 10%, depending on your business) determines in large measure the profitability of your business. Consider how often they buy, how large their orders, and how well they pay. Those are the obvious things. But now consider also the special price concessions you might give them in appreciation for their business. Do you extend special services to them in delivery, warranty support, or other customer service? Do you extend payment terms or wait longer before you call Accounts Payable, all the while borrowing from your credit line? Do you process special turnaround orders or accept smaller orders than you really want to?

Each of these add-ons has a cost, in people time or cost of money - a real cost of servicing that account. This is not to say you shouldn't do it, but you need to truly know how profitable that account is in order to make the best decision for your company. Your largest customer isn't always your most profitable. And if you're giving those concessions because you're building a relationship that will pay off "later," ask your customer when they will be willing to pay you more money tomorrow for what they pay less for today.

2. How much does each product you sell really cost you?

Why? Because if you lose money on every product you sell, it's really hard to make it up on volume. I am amazed at how many companies figure their all-important Gross Profit on a product by deducting from the selling price only the direct costs of manufacture or purchase. Often this is calculated as an average for an entire department, or even entire factories, rather than for the individual product itself.

Unfortunately, this is virtually never the true cost of a product you sell. Consider the costs to receive, package, warehouse, and deliver the product. How about servicing the warranty on its performance? The development cost if it's your proprietary product? The commissions you paid your sales team?

And then there's the overhead cost of running your plant or warehouse - costs related to having the facility ready and manned for your operations, from the lights and extra insurance to the stock pickers' wages to the janitorial service and the maintenance contracts on your equipment. If one of your products requires a disproportionate amount of overhead costs, an average overhead calculation for your company as a whole will never give you the right answer. Your most popular item could be a loss leader without your even knowing it.

3. How quickly does your inventory revolve, or turn over, during a year?

Funny things happen to inventory that doesn't move out of your warehouse pretty quickly. It disappears. Or it breaks. Or it becomes old, obsolete, or generally unusable. Or it just gets misplaced or lost, sometimes to be found again soon after you've bought more. Or the market price comes down and you have to mark it down to sell it. All of these results take money out of your pocket without giving you any benefit in return.

The first step in preventing all these bad things from hitting your bottom line is to know how quickly your inventory turns and to note any changes in that rate. This is step one in preventing inventory losses, followed closely by refining the overall turnover rate to an item-specific turnover rate, at least for high cost items. Why the detail? Because expensive items that don't move may be hidden by fast moving commodity items on your floor that have much lower margins.

4. How quickly do your receivables get collected?

This sounds like a no-brainer to most folks including, I'm sure, nearly all my readers. So, ask yourself this: What is the average day's sales in your current accounts receivable balance (often called "DSO")? Need to look it up or ask Accounting? Hmmmm. Too often we believe the concept but don't follow the practice. Collections get out of hand without our realizing it, because we're busy selling more and "managing the growth."

One idea: decide how much interest-free money you are willing to lend to your customers as a percentage of sales, and stick to it. Follow the trend of your DSO and take action when it starts moving in the wrong direction, unless strong margin gains are available in return for extending terms, and then do it deliberately, not accidentally.

As a follow-up, watch your A/R aging trends as well, because old balances look the same as new balances in a DSO calculation, and it's statistically proven that the older those balances, the less likely they are to be collected.

5. If your business does what you expect it to, when will your cash reach its highest point of the year? The lowest point? And how much cash will that be, roughly?

Everyone seems to agree they'd like to know those answers, in order to plan for short-term borrowing needs, or to explore investment opportunities in advance. And yet few small business people believe they can get the answer in any way that's reasonably reliable or cost-effective.

Many CEOs track their idea of cash flow by following net income and the bank balance, neither of which is going to be very useful in predicting future cash needs for most businesses. Capital asset purchases, growth in inventory, receivables and payables, debt service, capacity expansion - all can have a profound influence on future cash balances, and all are reasonably predictable with a little work in the form of a rolling cash forecast.

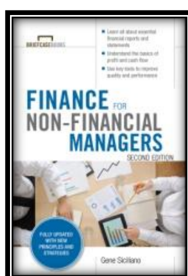
If you don't have the answers to these questions, and that bothers you, it might be time to call for help. We help. 310-645-1091 or 888-788-6534.

Contact me for more information.

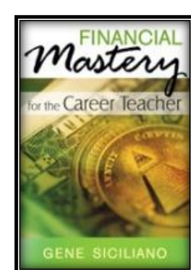
Gene

Gene Siciliano, ***Your CFO for Rent®***

Finance for Non-financial Managers, 2nd Edition, McGraw-Hill 2014, covers 14 key topics in the increasingly demanding world of business finance. This new and significantly expanded revision includes a wealth of new material, following on the heels of the best selling original. Because managers can no longer afford to be non-financial.



Gene brings his extensive financial management acumen and plain language writing style to the world of personal finance with ***Financial Mastery for the Career Teacher,*** Corwin Press 2010. Written at the urging of an educational publisher, the guidance and strategies in this book will work for professional people well beyond the education industry.



Gene Siciliano is the founder and president of Western Management Associates, source of *Your CFO for Rent* ® services for over 25 years. The firm provides interim and part-time CFO/Controller services, executive coaching and guidance in operational finance and exit strategy. Gene and his team of seasoned CFOs and controllers have a clear mission in their work with CEOs and owner/operators of privately owned companies. Our value proposition:

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