Scottsdale

Financial plans vital to business success

by **Jane Larson** - Apr. 9, 2008 12:48 PM
The Arizona Republic

SCOTTSDALE - A lot of entrepreneurs get too busy working in their businesses and, often lacking a background in accounting anyway, avoid the financial aspects of their companies.

"They're making a considerable mistake," says Luis Reynoso, business counselor with the Maricopa Community Colleges' Small Business Development Center. "The No.1 reason for failure is inadequate planning and record keeping."

Yet financial plans are vital to a business' success. They tell you where you stand and help you make decisions, for one thing. And you need them so you can pay the business' taxes and give lenders the information they need to make loans to the business.

Financial planning was the final topic in the four-week series on "Starting and Staying in Business" that Reynoso taught for the city of Scottsdale's Economic Vitality Department.

Financial plans should include three main reports, Reynoso said. Specifically:

The balance sheet.

This report is a snapshot of a business at one point in time. It shows what the business owns, including current assets, or bank accounts and other things that can be converted to cash quickly; fixed assets, such as a building, vehicles and machinery; and intangibles, such as customer lists or patents.

The balance sheet also shows liabilities, or what the business owes.

The difference between the assets and the liabilities is the owners' equity.

The income statement.

This describes the business' performance over a period of time.

It starts with total sales or revenue. From there it subtracts the cost of goods sold and other operating expenses such as rent and salaries. The bottom line shows profit or loss.

The cash flow statement.

This report summarizes the cash inflows and outflows over a period of time. It is useful for measuring the velocity with which a business turns over its goods and gets paid.

Often, businesses have cash flow problems when they pay suppliers and employees promptly but don't collect from customers or insurance companies for two or three months, Reynoso said.

Business owners can hire a bookkeeper to handle the day-to-day finances, an accountant to handle tax filings or a payroll service to administer employee pay. In any case, he said, they should keep personal finances separate from the business' finances, and they should not spend tax money they collected and owe the government.

Business owners can use their financial statements to create a budget, which estimates sales activity and projects expenses. Having a budget provides benchmarks to compare actual results to, and gives you an idea of any seasonality in the business.

Lenders pay close attention to the financial statements. From the statements, they will determine ratios including your accounts receivable and inventory turnover, liquidity, return on investment and profitability. They then can compare your ratios with industry standards.

Lenders also will consider factors such as your personal assets and credit history; the length of time the company has been in business; and possible collateral such as real estate.

Types of loans vary. Loans may be for commercial real estate, equipment leases, lines of credit, or guaranteed by the U.S. Small Business Administration.

Pricing of loans also varies. The "cost of funds" model calculates prices daily. Variable rates are tied to the prime rate, or rates can be fixed for terms of one or more years.

"Lenders will look at the statements very carefully, because every business has a certain capacity for generating wealth and profits," Reynoso said. "The bank wants to see if you can repay the loan."

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