The Small Business

REPORT CARD

AMERICA'S SBDC ILLINOIS

Illinois Small Business Development Centers

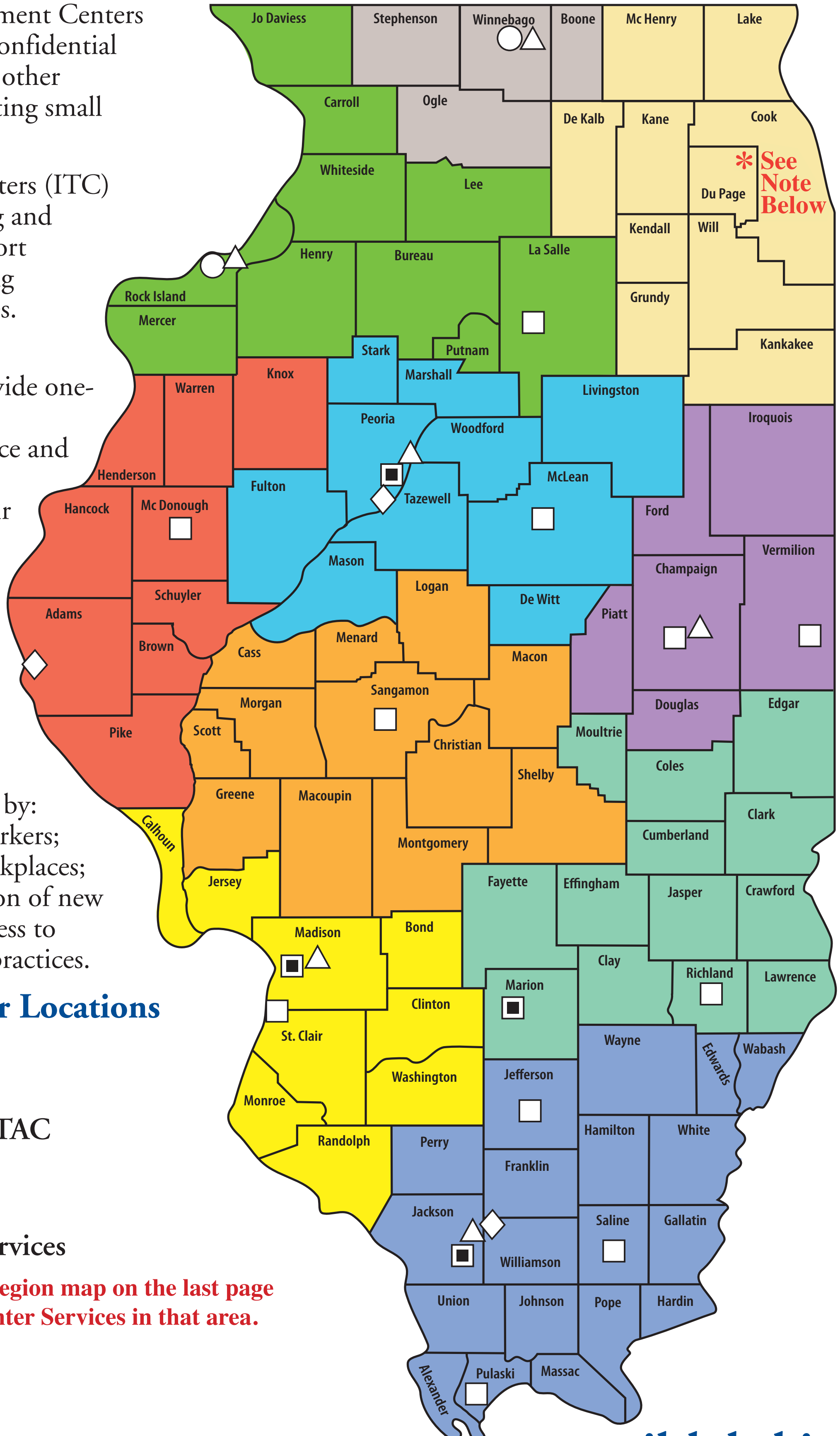
"Experts, networks, and tools to transform your business"

Illinois Small Business Development Centers (SBDC) provide information, confidential business guidance, training and other resources to early stage and existing small businesses.

Illinois International Trade Centers (ITC) provide information, counseling and training to existing, new to-export companies interested in pursuing international trade opportunities.

Illinois Procurement Technical Assistance Centers (PTAC) provide one-on-one counseling, technical information, marketing assistance and training to existing businesses that are interested in selling their products and/or services to local, state, or federal government agencies.

Technology, Innovation and Entrepreneurship Specialty (TIES) ten SBDC locations help Illinois businesses, entrepreneurs and citizens to succeed in a changing economy by: developing the skills of their workers; promoting safe and healthy workplaces; assisting in the commercialization of new technologies; and providing access to modernizing technologies and practices.



Business Center Locations

- □ SBDC
- ▣ SBDC/ITC
- ○ SBDC/ITC/PTAC
- ◉ SBDC/PTAC
- ◇ PTAC
- △ Technology Services

*See the Northeast Region map on the last page for the Business Center Services in that area.

AMERICA'S SBDC ILLINOIS

www.ilsbdc.biz

800-252-2923

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The Small Business REPORT CARD

Do You Really Know If Your Business Is Performing Well?

If you own a business, you know how much hard work and dedication it requires. Sometimes your energy is so focused on day-to-day operations that you forget to step back, look at the big picture and gain valuable perspective.

How can you tell if your business is performing well? By using numbers from your company's financial statements, you can calculate ratios and formulas that grade the performance of your business. This report card reveals the strengths and weaknesses of your company – and provides an opportunity for solid improvement.

By comparing your grades to industry averages, acceptable lending ranges and prior years' performances, you will begin to develop "big picture vision." Remember, these are averages of the health of your business, so expect your current grades to fall above or below them. Factors that can create differences include the company's age, the number of locations, the expertise of managers and the efficiency of operations.

CONTENTS

PAGE

FINANCIAL STATEMENTS

This book will walk you through the two financial statements that are used to calculate ratios and formulas – the Balance Sheet and the Income Statement. These two statements will help provide a clear understanding of your business health, but remember that they need to compare the same time periods (this year vs. last year, this quarter vs. last quarter).

The Balance Sheet is one day in the life of a business, frozen in time. This statement shows what is owned (assets), what is owed (liabilities) and the net worth or equity of the business (capital).

The Income Statement is a moving picture that spans whatever length of time you determine. It displays both income and expenses, revealing the net profit or loss over a period of time. It also shows the interest you have paid on loans.

There are a handful of other names for the Income Statement, including Income and Expense Statement, Operating Statement, Earnings Statement and Profit and Loss Statement (P&L). No matter what it's called, this statement will help you focus more clearly on your business' performance.

The information in this book is designed to help you "score" some insight into the performance of your business.

ASSET MANAGEMENT

In a business, assets are like fuel. But how effectively are you managing them? Formulas 1 & 2 have the answer.

1 Accounts Receivable Turnover

FORMULA

A

Accounts Receivable ($75,000 x 365 days)

$$\frac{\$27{,}375{,}000}{\$900{,}000} = 30.4$$

It takes 30 days to collect bills

B Net Sales Figure

What It Shows ▶ How many days it takes to collect money owed to you. *A lower answer is better.*

The Number Source ▶ Balance Sheet and Income Statement

The Goal ▶ To reduce turnover time

The Plan ▶ Right now, the Accounts Receivables turnover is $75,000/30 days, or $2,250 per day.

If Accounts Receivable are collected just four days faster, (in 26 days instead of 30), the result is $9,000 in extra cash (4 days x $2,250).

2 Inventory Turnover

FORMULA

C

Inventory of $85,000 x 365 days

$$\frac{\$31{,}025{,}000}{\$540{,}000} = 57.4$$

57 days to turnover or sell the inventory

D Cost of Goods Sold

What It Shows ▶ How many days it takes to turn over (or sell) your inventory. *A lower answer is better.*

The Number Source ▶ Balance Sheet and Income Statement

The Goal ▶ To reduce excess inventory

The Plan ▶ Inventory now turns every 57 days, equaling $1,491 per day. (Ending inventory of $85K divided by 57 days)

If inventory is re-stocked every 30 days instead of 57, you cut 27 days from the formula. At $1,491 per day, the result is a $40,257 savings in inventory expenses.

BALANCE SHEET Year End / As of Dec. 31

Assets			
Current Assets:			
Cash	10,000		
Accounts Receivable	75,000 A		
Inventory (ending)	C 85,000		
Total Current Assets		170,000	
Non-Current Assets			
Fixed Assets	140,000		
Less Accumulated Depreciation	(25,000)		
Fixed Assets (net)	115,000		
Advances to Owners	6,000		
Total Non-Current Assets		121,000	
Total Assets (170+121)			291,000
Liabilities			
Current Liabilities			
Current Portion of Long-Term Debt	6,000		
Note Payable	100,000		
Accrued Taxes	3,000		
Accounts Payable (A/P)	41,000		
Total Current Liabilities		150,000	
Long-Term Liabilities/Loan Payable	54,000		
Total Liabilities (150+54)		204,000	
Capital or net worth			
Owners Investment	20,000		
Retained Earnings	67,000		
Total Capital		87,000	
Total Liabilities & Capital (204+87)			291,000

Remember: *Both statements must reflect the same time period.*

INCOME STATEMENT January 1- December 31

Sales		
Net Sales		900,000 B
Cost of Goods Sold:		
Beginning Inventory	75,000	
Purchases	350,000	
Labor	200,000	
Total		625,000
Less: Ending Inventory		(85,000)
Cost of Goods Sold (625 less 85)		540,000 D
Gross Profit (900 less 540)		360,000
Expenses		
Operating Expenses:		
- Selling Expenses	90,000	
- General & Administrative	170,000	
Total Expenses		260,000
Operating Income (360 less 260)		100,000
Interest Expense		20,000
Profit		
Net Profit before taxes (100 less 20)		80,000
Less: All Income Taxes		27,000
Net Profit (80 less 27)		53,000

LIQUIDITY

Liquidity indicators show a company's ability to turn an asset into cash. How "cash rich" is your company? Formulas 3, 4 and 5 have the answer.

❸ Working Capital

FORMULA

E Current Assets

$$\frac{\$170{,}000}{-\$150{,}000} = \$20{,}000$$

in Cash, Accounts Receivable and Inventory

F Subtract Current Liabilities

What It Shows ▶ Whether a company has enough current assets to operate the business on a daily basis, and to pay its current bills. *Higher numbers are better.*

The Number Source ▶ Balance Sheet

The Goal ▶ To keep enough money on hand for daily operations. The answer must be positive. If the answer is negative, more money is needed to meet expenses.

The Plan ▶ By following the tips on this page, working capital is preserved. Note: This business has an excess amount after paying all current liabilities.

❹ Quick or Acid Test Ratio

FORMULA

C Total Current Assets of **$170,000** less Inventory of $85,000 E

$$\frac{\$85{,}000}{\$150{,}000} = .56$$

F Total Current Liabilities

What It Shows ▶ If inventory should become obsolete, this ratio eliminates it from current assets and cash. The ratio is called "quick" because it includes items that can be turned into cash quickly.

The Number Source ▶ Balance Sheet

The Goal ▶ The answer should be 1 or higher.

The Plan ▶ By following the tips below, inventory is managed properly.

❺ Current Ratio

FORMULA

E Total Current Assets

$$\frac{\$170{,}000}{\$150{,}000} = 1.13$$

F Total Current Liabilities

What It Shows ▶ This ratio reveals a company's ability to pay short-term debt. *A higher number is better.*

The Number Source ▶ Balance Sheet

The Goal ▶ The answer should be 2 or more, meaning the company has twice as many assets as liabilities. This example means there is $1.13 available in cash and current assets to pay every $1 of current liabilities.

The Plan ▶ Take advantage of the tips below.

BALANCE SHEET Year End / As of Dec. 31

Assets			
Current Assets:			
Cash	10,000		
Accounts Receivable	**75,000**		
Inventory (ending) C	**85,000**		
Total Current Assets		170,000 E	
Non-Current Assets			
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Tips for Improving Your Score for Formulas ❸, ❹ and ❺

- Collect Accounts Receivable quicker with a better credit policy (see Formula ❶ on page 4)
- Decrease inventory turnover (see Formula ❷ on page 4)
- Pay Accounts Payable faster and take advantage of trade discounts (see Formula ❼ on page 6)
- Increase profit margins by raising prices and selling more products/services (see Formula ❾ on page 7)

DEBT MANAGEMENT

Investing in a business is serious business. To find out how much money owners have invested versus lenders, plug your numbers into Formulas 6 and 7.

6 Leverage or Debt-to-Worth Ratio

FORMULA

$$\frac{\$204{,}000 \text{ (H: Total Liabilities)}}{\$87{,}000 \text{ (I: Total Capital)}} = 2.34$$

What It Shows ▶ Whether a company has enough equity.

The Number Source ▶ Balance Sheet

The Goal ▶ An answer of 3 or lower is preferred. This company is leveraged 2.34 times, meaning for every $1 owners have invested, lenders and creditors have invested $2.34.

The Plan ▶ Decrease leverage by increasing the amount of money earned and kept in retained earnings.

BALANCE SHEET Year End / As of Dec. 31

Assets			
Current Assets:			
Cash	10,000		
Accounts Receivable	**75,000**		
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7 Accounts Payable Turnover

FORMULA

$$\frac{\text{Accounts Payable at } \$41{,}000 \text{ (G)} \times 365 \text{ days} = \$14{,}965{,}000}{\$350{,}000 \text{ (J: Purchases)}} = 42.75 \rightarrow 43 \text{ days}$$

What It Shows ▶ How quickly a business pays its suppliers.

The Number Source ▶ Balance Sheet and Income Statement

The Goal ▶ To pay bills faster. Lower numbers (30 days or less) are better. This business now takes 43 days to pay its suppliers.

The Plan ▶ Take advantage of discounts that often apply if a bill is paid early. "2%, 10 days, net 30 days" means 2% may be deducted from an invoice if it's paid in 10 days. *For example, if the $350,000 in annual purchases was paid in 10 days, the savings would be $7,000 yearly.*

INCOME STATEMENT January 1- December 31

Sales		
Net Sales		**900,000**
Cost of Goods Sold:		
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PROFITABILITY

No matter what kind of product or service you provide, turning a profit is the goal. So how are you doing? Formulas 8 and 9 give you the bottom line.

8 Cash Flow to Current Maturities or Debt Service Ratio

FORMULA

M

Net profit of $53,000 plus $13,000 in depreciation
(number created for this example)

$66,000 / $6,000 = $11

For every dollar of payments $11 is available to pay it

L Current Portion of Long Term Debt

What It Shows ▶ Your ability to pay term debts after owner withdrawals.

The Number Source ▶ Balance Sheet and Income Statement

The Goal ▶ An answer of 2 or more is preferred. New businesses use one year's worth of loan payments instead of the Accounts Receivable figure.

The Plan ▶ To increase debt service, do three things:
1) refinance at a lower rate, 2) ask if you can pay interest only on loans for a period of time, and 3) consolidate debt in order to pay it back over a longer period of time.

Due over the next year or $500 per month

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9 Profit Margin on Sales

FORMULA

M Net Profit

$53,000 / $900,000 = .0588

5.9% profit margin when converted to a percentage

N Net Sales

What It Shows ▶ The percentage of net profit for every dollar of sales.

The Number Source ▶ Income Statement

The Goal ▶ The higher the number, the better.

The Plan ▶ To increase your profit margin, follow three courses of action: raise prices, lower the cost of goods and reduce expenses.

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Loan to be paid back over time. $60K loan with $54K due over time and $6K due in one year - Current Portion of Long-Term debt

REPORT CARD

		PAGE	BOOK ANSWER	COMMENT	STANDARD
Assets	❶ Accounts Receivable Turnover	4	30.4 days	Good	30 days
	❷ Inventory Turnover	4	57.4 turns	Good	Match Industry
Liquidity	❸ Working Capital	5	$20,000	Good	Positive Number
	❹ Quick or Acid Test	5	.56	Increase	1 or more
	❺ Current	5	1.13	Increase	2 or more
Debt	❻ Leverage (or Debt-to-Worth)	6	2.34 times	Good	3 or less
	❼ Accounts Payable Turnover	6	42.75 days	Decrease	30 days
Profit	❽ Cash Flow to Current Maturities (Debt Service)	7	$11	Good	2 or more
	❾ Profit Margin on Sales	7	5.9%	Good	Match Industry

WHAT MAKES A BUSINESS GO ROUND?

EVERY SUCCESSFUL BUSINESS PUTS A SPIN ON MAKING THE OPERATING CYCLE TURN FASTER. THE FASTER THE CYCLE, THE BETTER YOUR BUSINESS' GRADES AND THE MORE MONEY YOU SAVE.

For example, the savings shown in these three ratios **total $56,257:**

FORMULA ❶ shows how collecting Accounts Receivable faster can produce $9,000 in extra cash. See page 4.

FORMULA ❷ Shows how restocking inventory every 30 days saves $40,257 in expenses. See page 4.

FORMULA ❼ Shows how paying bills faster results in a $7,000 savings. See page 6.

Compared To What?

How Industry Standards Can Lend Valuable Perspective

Knowing what the average grades are for your industry really gives you a barometer for assessing the performance of your own company. Use your business' North American Industry Classification System (NAICS) code number to compare your grades to industry standards. Find your number at *www.sba.gov/businessop/standards/naics.html*

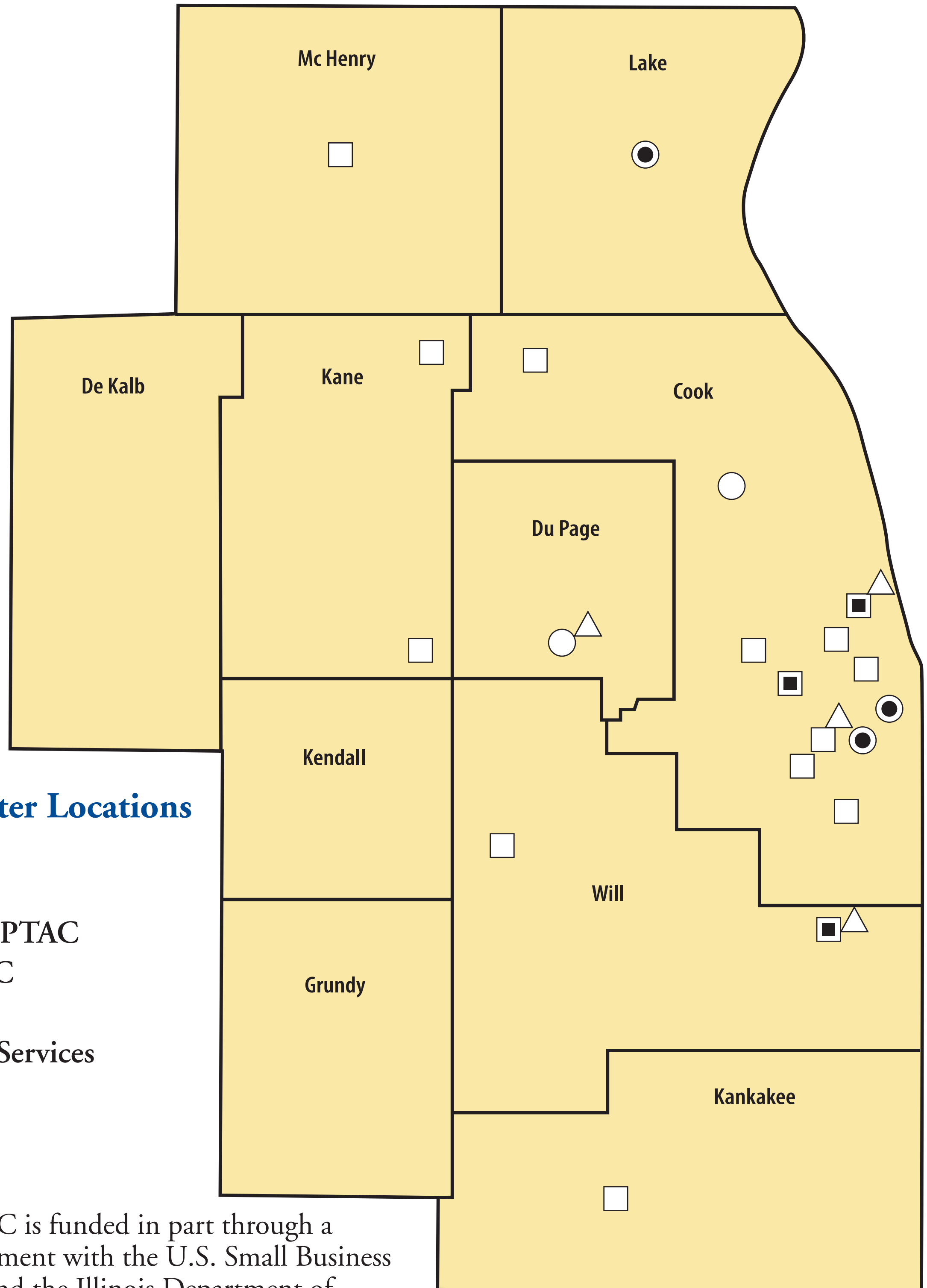
Industry Resources

Check your library or the Internet for these resources:

- Small Business Administration/SBA
- Risk Management Association Annual Statement Studies
- Dun & Bradstreet's Key Business Ratios
- Prentice Hall's Almanac of Business and Industry Ratios
- Your local, regional and national trade associations

Northeast Region

"Chicagoland"



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