8 KEY FINANCIAL QUESTIONS EVERY BUSINESS OWNER MUST ANSWER

To earn more, worry less, and transform your business into a vibrant, healthy, self-sustaining asset that produces income and wealth over the long haul.

MICHIGAN CFO ASSOCIATES

Dear Friend,

The pressures of a business owner are many. And arguably, the biggest concerns revolve around money. Without it, the business fails, creating a domino effect with all the employees of the business including you – the owner. As such, **I'm respectfully requesting a few minutes of your time to consider the contents of this report**, and how it can positively affect the financial health of you, your family, and your business.

The many ongoing financial concerns of a business owner can literally suck the confidence out of even the most sure-minded individual – they are legitimate, real issues and should not be left to chance, or ignored.

We compiled this report after repeatedly seeing business after business struggle with the same issues, or worse yet, ignore these issues altogether. Our goal is to help you ask the right questions of yourself and your organization and provide some insight on how other business owners have answered these questions, and propelled their companies to the next level.

In just a minute, I'm going to share what the 8 Key Questions are, but first let me answer another question that may be on your mind right now:

"Who are you and why should I listen to you?"

My name is Todd Rammler, I am an accountant by trade, I've worked as a Chief Financial Officer for the last 15 years, and I'm the President of Michigan CFO Associates. Our firm works with privately held businesses acting as their "Virtual CFO". We are known as **The CFOs for Small Business,** and we work with dozens of business owners in almost every industry bringing focus on critical financial issues such as the **8 Key Financial Questions** identified in this report.

Our work is not the same as what your CPA does – we don't do tax returns or audits. Our mission is to improve cash flow and profitability by bringing techniques large companies use down to small-businesses.

Over the years, we've seen our share of businesses fail because the owners were unaware of these issues, or unwilling to address them. We've seen lots of mistakes as well as lots of successes – and that puts us in a good position to share the common success factors with business owners who are truly seeking continuous improvement – not just giving lip service to it. Business owners like you.

Okay, now that you know who I am, let's get started with the 8 Key Financial Questions...

QUESTION #1:

Do you receive a weekly cash flow forecast that provides you with visibility of your cash inflows and outflows for the next 12 weeks?

For some businesses this question is important; for many, it is absolutely critical. Like most business owners, you probably already know that cash is the lifeblood of business. Also like most business owners, you probably don't use this simple tool. Less than 1 in 10 businesses we talk with have a weekly cash forecast – until we show them how to do it.

If cash is so important, why don't more businesses use a tool like this? There are many reasons, including not knowing how to do it, assuming it won't be accurate, or perhaps no one ever thought about it. And quite frankly, it's a bit tedious to maintain.

Nevertheless, it is worth doing. It is the only way to know if you've got a problem coming at you. Done right, it allows you to see recent history, and peer into the future so that you have time to react to problems, and data to make decisions. Without it you are hoping everything works out. Good luck.

Sometimes business owners conclude that because activity is high (sales, production, overtime, etc.), and profits are high, that cash will take care of itself. Not necessarily, and perhaps not on the timeline you were expecting.

Even though your business may be profitable, Cash Flow can still be uncomfortably tight.

We recommend that all of our clients – regardless of their cash situation – implement a weekly cash forecast. It is amazing how much more confident and 'in control' you will feel when you consistently use this tool. And for the record, we use it in our business every week. This one simple-to-use tool will allow you to clearly see and manage CASH FLOW and has provided more restful nights than any other single tool I'm aware of.

> *"Even though your business may be profitable, Cash Flow can still be uncomfortably tight."*

QUESTION #2:

Are you generating enough personal income from your business for the amount of effort and risk you've taken on?

Ok, this one might hurt. But it's a question we get fairly regularly, and a question you need to answer honestly for yourself.

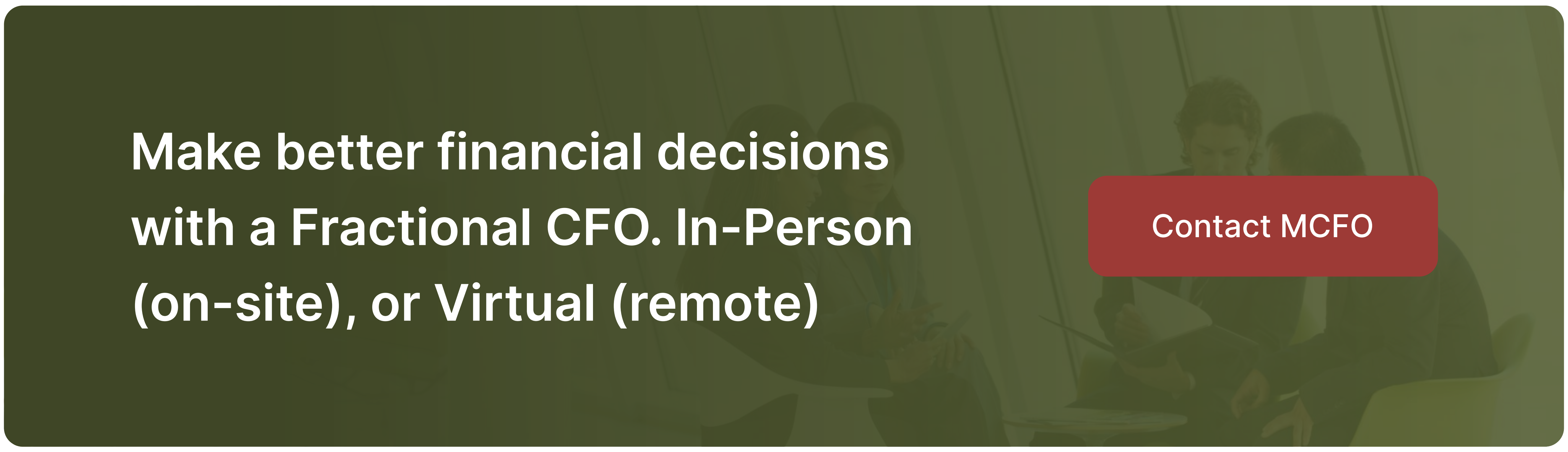
Over the years we've seen business owners that have lost their perspective on the responsibilities they have, how much effort is required from them, and how much risk they have in OWNING a business.

Some will settle for a level of compensation that they could easily earn as an employee in a traditional job. Even during a record year in sales (as with a recent business owner I spoke to).

There is inherently more risk in owning a business, than in having a job. Therefore, the rewards should be significantly better – or something must change.

We have seen businesses where company A is generating 10 times the revenue of company B, yet the owner of company B is making more personal income. . . with LESS RISK (less equipment, less debt, fewer employees, lower receivables, etc.).

Having a clear understanding about what your business can generate for you in personal income is critical in evaluating the relationship between the risk and return you should expect in the form of compensation.



QUESTION #3:

How do you know when to add additional overhead?

One of the most frequent questions we get asked by clients is: How do I know when I can afford to add another ______ (person, location, machine, etc.).

Interestingly, we didn't hear this question nearly as much before the last economic slowdown. But through that downturn period, a lot of businesses cut a lot of overhead, and now they are VERY reluctant to add it back, even though the economy is substantially better.

It is a prudent question to ask. We've heard many business owners say "I'm not going through that pain again".

The beginning of the answer requires that you have accurate financial reporting that isolates the key performance drivers in your business. If you have good information and a person capable of accurate analysis, the question is fairly easy to answer.

The problem is, most businesses have truly terrible financial reporting. Which brings us to our next question. . .

QUESTION #4:

Are your financial reports useful for decision making?

For a growing business, understanding financial statements, the key relationships in the statements, and what to do with this information can be the difference between growth and success, treading water or even failure.

In order to make good financial decisions, we need to understand our numbers inside and out. This comes from having accurate, timely, useful financial reports every month, and enough understanding to act on this information. Financial statements are not simply a scorecard or grading system you get after the "period" is over. They should be used as a set of tools to generate the outcomes you want. Over the years, we've shown many smart people why the financial statements they've been using to run their businesses were nearly useless as a management tool.

Many business owners simply don't know how to read and interpret financial statements -- and it's really not their fault. No one requires a business owner to learn these things. And while there are a myriad of books & seminars on understanding

Financial Statements, a good portion of these are truly lacking any real, practical help. Accounting is a bit contradictory: full of rules and regulations on one hand, and yet having vast, grey areas that are open to interpretation on the other. Ask ten accountants how much overhead costs should be included in your pricing and you're likely to get ten different answers. Several of which might send you to the poor house.

The financial statement you need to make good decisions are not your CPA prepared "GAAP" Financial Statements (Generally Accepted Accounting Principles). You need useful, practical, run-the-business financial statements. Your CPA has never given you anything close to what we're talking about here -- nor should they. That's not what their role is about. The CPA's objective is primarily compliance (with GAAP, IRS, etc.), while your objective is to have a tool that is actually useful in managing the business month in and month out.

Some of the reports you should review on a regular basis include:

- Budget vs. Actual Income Statement
- Year-over-Year Income Statement
- Contribution Report (or Margin Report)
- Job Cost/Profitability (if applicable)
- Relevant Metrics/Key Performance Indicators

> *" We've shown many smart people why the financial statements they've been using . . . were nearly useless as a management tool."*

For most business owners, the Income Statement (or Profit and Loss, or P&L) is the financial report they understand better than any other. It is conceptually simple, however many businesses fail to use it for anything beyond a basic measure of profit or loss. The average business owner looks at the top line (revenue) and the bottom line (profit or loss) but does not fully understand how the business performed and got from the top of the page to the bottom.

Further complicating the matter is poor report formatting. Before we begin a new client engagement, we review the financial statements and management reports the company uses to manage the business so that we have a good understanding of what they're accustomed to seeing. Frequently, when we review a prospective client's financial statements, we find that these reports provide little insight as to what drives the business, due to the lack of useful data contained in the reports.

> *"Canned financial statements that come with your software program are not effective tools for managing your business".*

There are two main reasons why business owners use sub-par financial statements:

1. First, most accounting systems are preloaded with very basic financial statement formats, so that even a monkey could print out a financial statement. Unfortunately, in order to make this process simple for the monkey, the software programmer has to include every line item on the report, thus making it a laundry list of accounts rather than the useful tool that it should be. But it's not really the programmer's fault, which leads us to reason #2:

2. The bookkeeper or financial person in the company doesn't really know a good financial statement format from a bad one, and they assume that if the software program comes with 7 financial reports, the folks who wrote the software program must know what they're doing. And since they don't know good from bad, useful from useless, this is what the business owner gets. A steaming pile of garbage, he or she is supposed to use to manage a multi-million dollar company. Canned financial statements that come with your software program are not effective tools for managing your business.

In order to set up an Income Statement for simple, effective analysis, here are some general guidelines:

1. One Page Format. Use a one page, “Contribution Style” Format. All financial statements (not just the P&L) should be 1 page only. If you want to use extra-large paper, go ahead, but all the data should be on one page so we can see it all together. “Contribution Style” means we segregate variable and fixed costs for additional insight.
2. Less is more. Businesses often make the mistake of showing way too much detail on a financial statement. What we’re looking for are the key line items that are relevant to decision making.
3. Trending provides perspective. When looking at your existing Income Statement, would you be able to tell if an expense was missing. . . or recorded twice? Would you know if payroll taxes this month are high or low? Without comparable data as a reference point, it’s difficult to evaluate financial statements. So we recommend using a “Trended” format. That means we show recent months as well as the current month data.

Financial reports must be accurate, useful and timely in order to be an effective management tool. Without them, you cannot make informed decisions.

QUESTION #5:

Do you know how to leverage the dollars you’re spending on accounting staff to get the MAXIMUM RETURN on this investment?

Here’s the problem in many businesses: you’re trying to grow a multi-million dollar business. . . using the lowest cost financial team you can possibly get.

In many cases you don’t even realize the financial “blind spots” in your business due to the absence of accurate analysis and experience in getting the right data, interpreting the data and ACTING on the data.

And the worst scenario is where the owner (you) is actually doing some or all of the bookkeeping, for one bad reason or another.

Can your accounting team follow your vision for the business and take it to the next level? What skills are needed?

Invest in the right resources for the job. . .

At most businesses we work with, there is one primary financial person who may be titled as a Bookkeeper, Accounting Manager, or Controller. Maybe the primary person has a clerical helper or two. So let's assume for discussion purposes that you have a Controller as your primary financial person, but don't get hung up on the title of the position.

If you broke down the financial tasks that need to get done, you'd see that you're overpaying for certain tasks, paying an appropriate amount for some tasks, and underpaying for others. In most cases, underpaying means either the task isn't getting done, or it isn't getting done right.

When we're working with a new client, we try to assess what work needs to get done, and then select the most appropriate resource for that task. There's no sense using an expensive resource (like a Controller) to do repetitive, transactional tasks such as Accounts Payable. Conversely, there's no sense asking the A/P person to develop your pricing methodology. They're not capable of this.

So what we're really talking about is matching the work load with the appropriate resource. The example above was an obvious one, to make the point. But when you're analyzing what a higher cost resource does (like a Controller or CFO), it may not be so obvious, especially if you have no accounting background. Again, we are trying to minimize the tasks you are either overpaying for (inefficient) or underpaying for (ineffective).

> *"What 'Top 20%' tasks are there in my business that are not getting done, or are not getting done right?"*

In the hiring process, this is where compromise usually enters the picture, as most businesses cannot justify the cost of a Controller or CFO that is capable of getting the "highest level" items done correctly, so they settle for a mid level person that can get 60% or 80% of what they need done, but they're missing out on the top end tasks – that in the long run are the most important. (Financial analysis, budgeting, planning, strategic thinking, etc.)

And it makes sense, because you wouldn't want to hire a 6-figure CFO full time, when you only need the expertise of a 6-figure CFO 20% of the time. But it's the top end tasks that are most critical.

There hasn't been an obvious solution to this problem in the marketplace until recently, with the growing use of "virtual" or "outsourced" CFOs – like Michigan CFO Associates (a shameless plug, I know).

There are two 'takeaways' to note:

1. Make SURE you're getting the highest 20% of financial work done by a competent person as it is THE most important work;
2. Match the resource with the work in order to do (1) as efficiently and cost effective as possible.

Better to do (1) and not (2) than vice versa. First, get the important work done; then make it efficient.

The importance of getting "the top 20%" done by a capable person cannot be overstated.

The follow up question for you is: "What 'Top 20%' tasks are there in my business that are not getting done, or are not getting done right?" This requires an honest evaluation from you if you're objective is truly maximizing the health, longevity and profitability of you business.

What are some examples of 'Top 20%' tasks?

- Ensuring that the company's reporting contains data that is BOTH accurate and useful for decision making
- Bringing focus on the key items that have the greatest impact on profitability
- Instilling basic financial disciplines and controls
- Creating projections to identify future problems and opportunities
- Assisting with outside relationships (bankers, vendors, customers, CPAs, etc.)
- Providing leadership and training to the company's accounting staff
- Assisting the owner with difficult decisions

Another Hidden Risk. . .

Many businesses do not realize how vulnerable they are to a key staff person leaving. This applies to any discipline within the business, but for our discussion, we'll focus on the financial and office people. Too many businesses allow their people to work with no documentation on how they do their jobs – leaving you at substantial risk if that person departs abruptly. It also puts you in the position of having to hold back on letting someone go if you don't have the ability to transfer their knowledge to a new person.

We recommend that key positions have both a list of job duties and a detailed work instruction document that is regularly maintained. At our company, work instructions contain not only verbal instructions but also screen shots of the relevant computer tasks. With this tool, almost anyone could follow along and get any task done if they had to. And it makes training a new person much, much easier.

Recently we had a client who's bookkeeper abruptly quit. After the owners begged her to stay for a few extra weeks, she agreed, but held them hostage for a substantially higher pay rate - knowing that she had this leverage from accumulating knowledge no one else had. They were stuck, and it cost them additional pay, time and aggravation.

This one procedural change (requiring detailed work instructions) can literally save you thousands of dollars and eliminate a crippling risk that is almost certainly present somewhere in your business right now.

QUESTION #6:

If you needed additional capital from your bank, are you confident you could get it?

Most businesses need some form of credit to operate. Whether it's working capital to buy materials or pay employees, or term debt to make capital investments in the business, access to capital is one of the keys to long-term success. In fact, undercapitalization can cause up to 80% of small businesses to fail.

For many businesses this means requesting a loan or line of credit from a bank. Unfortunately the process can be intimidating, complicated, seemingly illogical, frustrating and sometimes adversarial. But it doesn't have to be this way. Like many things in life, experience and knowledge of the process and success factors often come through failing the first time or two. Unfortunately, in some cases failure to obtain the needed capital could ultimately mean failure of the business.

As sales grow, will you have access to the necessary working capital when you need it?

The first step in answering “YES” to this question is to treat the bank like a partner and develop a relationship with the people who handle your account. That may be several people, and perhaps the person one level up that they report to. Obviously you need to be bankable; but you also need people inside the bank “selling” your story to the loan committee.

Even if you don’t need the capital right now, it is wise to develop a relationship with key people at your bank so that if you do need to borrow in the future, you’ve already laid the groundwork. Relationships matter.

> *“Undercapitalization can cause up to 80% of small businesses to fail.”*

QUESTION #7:

Is someone – internal or external – looking out for your best interests?

In Question #5 we dealt with the limitations of your accounting staff as it relates to financial disciplines (their day in, day out work).

Often times, business owners feel like the employees are focusing only on their specific jobs and not seeing the bigger picture, or paying attention to the overall mission.

Whether inside or outside your company, do you have a knowledgeable person who understands the entire picture of your business – financial, operational, strategic, etc – who can look at the situation objectively and give you feedback, challenge you, and see things that you don’t see?

This is the invaluable perspective that is usually provided by a CFO, as not many people in or out of the company will know the entire picture well enough to form an opinion on it, or challenge you and punch holes in it.

It is much, much easier to clearly see an issue and the possible solutions in someone else's business, than it is in your own business. For whatever reason, it is difficult to "see the obvious" in your own company – maybe because we're emotionally attached to it, or we're just too close to the action. A good business coach or CEO peer group can also be an effective sounding board if they are given all the pieces of the puzzle.

Having an objective, well informed person acting as a sounding board for you can be invaluable.

> *"It is much easier to clearly see an issue and the possible solutions in someone else's business, than it is in your own business."*

QUESTION #8:

Do you have a well thought out Exit Strategy?

Many business owners are so busy working on today's problems and issues that they give little if any thought to how they plan to exit the business. When they finally realize it's time to sell, they've done very little to make their business attractive to a buyer.

One of Stephen Covey's "7 Habits of Highly Effective People" is to "Begin with the End in Mind". In business, beginning with the end in mind ought to include your exit strategy. Even if you haven't given much thought to exit strategy yet, you probably are hopeful that when you're ready to exit, your business has some value that can be used to fund your next step in life – another business venture, retirement, etc.

In many cases, the way to maximize the value of your business is to create predictable, repeatable, dependable systems. Systems that are NOT dependent on YOU.

Generally speaking, buyers will pay more for a "Turn-Key" business that operates without YOU, than they will a business that is heavily dependent on you. There is FAR more risk in the latter than the former.

For many owners, the #1 step that will make their business more attractive for purchase is creating systems and processes that reduce dependency on the owner.

Think about that: would you pay top dollar for a business where the owner was tied into some or all of the critical operations such as selling, quoting, product knowledge, day to day decision making, or new product development?

Probably not.

Obviously there are many benefits of removing organizational dependency on the owner – scaling the business, the ability to go on vacation without the business grinding to a halt, keeping a good balance between work & life, to name a few. But one of the bigger benefits is building business value in preparation for your exit. Michael Gerber's E-Myth is a great book on this subject.

> *". . . the #1 step that will make most businesses more attractive for purchase is creating systems and processes that reduce dependency on the owner."*

Creating a sellable business happens over time, not right before you're ready to exit. A little thought, planning and execution now can make a tremendous impact on the ultimate value of your business when you are ready to sell.

MICHIGAN
CFO
ASSOCIATES

Well, there you have it.

I hope that I've been able to get the 'wheels turning' for you, and that you've found a few areas to dig into further, to maximize the value of your business. If you have any specific questions, please feel free to contact me.

Best wishes for your success!

Todd Rammler, CMA
President
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Talk to our Expert and get a Free Consultation Today

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