

Financial Adviser

A Business Owner's Guide to Surviving Tough Economic Times

Among the dickest issues business owners will face in our downturned economy are lower consumer spending, rising unemployment, tightening bank credit and inflation. These pressures not only affect businesses but also customers, and likely will result in reduced business opportunities, decreased cash flow and lower profit margins.

To minimize potential reductions in cash flows and profit margins, businesses should place greater emphasis on budgeting. Budgeting can encompass elements of break-even analysis, income and cash flow projections and can be tweaked by industry benchmarking.

Effective Budgeting

A budget is basically an extension of one's business plan and strategy in quantifiable financial terms. A good budget determines how a business will make and use money and whether the owner can achieve his or her financial goals.

To do so, a business should prepare a break-even analysis, showing the amount of revenue needed to cover expenses and overhead before making a penny of profit. In preparing this analysis, be sure to make the following estimates and calculations:

- Annual fixed costs – expenses not affected by sales and that don't vary month to month.
- Average selling price – price received per unit of sales.
- Average gross profit from each sale – money left from each sale after paying direct costs.
- Average gross profit percentage – the portion of each dollar that is

gross profit. This percentage is the average gross profit from each sale divided by the average selling price.

To calculate break-even points, divide the estimated annual fixed costs by the gross profit percentage. This will determine the amount of sales the business needs to break even. If the point is higher than expected revenues, or the profit is lower than expected, the business will need to adjust the budget such as increasing prices, finding cheaper supplies or reducing the work force.

Income and Cash Flow Projections

A budget should incorporate income and cash flow projections. An income projection summarizes all revenues and expenses (including noncash expenditures such as depreciation) and attempts to determine monthly and annual profitability. A cash flow projection summarizes the amount of money available to make purchases and pay bills. Though these projections appear unrelated, the main difference is the timing of debt and principal payments and the purchase of capital expenditures and depreciation. Both projections provide monthly and annual checkups to determine that a company is following its plan toward financial success.

When preparing budgets and projections, look at the most recent months of actual operations, because the near future is likely to resemble the recent past. Be flexible, because if revenue doesn't equal expectations, the company may have to cut expenses. Since budgets and projections are estimates, be mentally prepared to miss projections. Be conservative; do not overstate revenue projections; and,

be reasonable when projecting profit margins, as the trick is to get close to the actual results. Check the budget each month to review cash flow needs and to keep expenses in line. You may have to reallocate some areas to keep the budget realistic. Use the budget as a restraint, but not a constraint, since it is impossible to foresee last minute opportunities.

Benchmarking

Industrial averages or benchmarking can be used to compare budgets and actual results to your industry. This will assist in determining the company's strong business areas and which ones need to improve. Benchmarking will also assist in analyzing how well a business and industry as a whole is performing and provide an early warning to fluctuations.

Malin Bergquist utilizes a proprietary Web-based financial analysis software suite that enables users to turn financial statements into plain language written reports. The reports use ratio and trend analyses as well as industry comparisons to analyze a business client's financial health, and to determine which financial areas exceed industry averages and which ones need improvement. For more information, contact Craig Moffatt at cmoffatt@malinbergquist.com.

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