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Manage Your Cash Flow with 3 KEY STEPS

One of the most important tasks you'll face as a small business owner is managing your company's finances. While your cash drawer or bank account balance can offer clues to the state of your finances, they don't show a complete picture.

Successful business management begins with keeping good financial records. This means developing and regularly using a bookkeeping system that helps organize financial information and makes it easy for you to stay up to date. Simply put, bookkeeping is the recording of your business's financial transactions. A bookkeeping system could be anything from paper ledgers or spreadsheets to financial software such as QuickBooks that helps you organize and track your finances.

A bookkeeping system helps you stay organized, run useful reports about the state of your business, and plan ahead for future success in your business. You'll learn more about each of these key benefits of bookkeeping in this article.

Most importantly, using a bookkeeping system allows you to keep a watchful eye on your cash flow–the amount of cash coming in and going out of your business. By knowing where you stand financially, you can ensure your business doesn't unexpectedly run short–or worse yet run out–of cash when you need it.

Why Use a Bookkeeping System?

While bookkeeping doesn't contribute directly to your bottom line, it is essential to your business for several reasons:

- By recording your business information in one place, you can keep track of the cash going in and out of your business. Knowing how much money your business has at any given time helps you avoid running low on the money you need regularly for expenses, such as paying bills or employees or buying inventory.
- A bookkeeping system lets you quickly generate reports about your business. It can help you make informed financial decisions for your company's future based on trends in specific areas, such as your sales, expenses, and profits. For example, reports can reveal which products or services are your best (or worst) moneymakers. Ultimately, informed decision-making can help grow your business–and boost your profits.
- To accurately report financial information to the IRS and other tax authorities, you need complete records of your company's income, expenses, and payroll. Without good records, you may be subject to fines and penalties.
- Bankers, investors, and the Small Business Administration typically require you to provide a complete set of detailed and accurate financial statements before they can consider giving you money for a loan or investment. Accounting is the language of business, so if you need outside financing–and many small businesses do–you need to maintain good records and procedures.

While you don't need to be an accountant to run a small business, you do need to have a basic understanding of bookkeeping and know how to perform some essential financial management tasks. Even if you know very little about business management now, by organizing your financial information and learning to tap the power of financial reports, you'll be better equipped to keep your business running smoothly, far into the future.

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Managing Your Cash Flow: Three Key Steps

Financial management of your business won't be a burden if you stick to three simple rules–all of which a bookkeeping system can help you master. If you follow these steps, you'll be able to stay on top of your finances and focus on what you do best–running your business.

1. Stay organized and record all your information in one place.

Keeping money in a cash box and writing receipts by hand may be all you need to sell your products to customers. But successful business management doesn't happen by stashing sales receipts in shoeboxes or recording information in multiple spreadsheets. Good bookkeeping starts with keeping all your data–including information about your company, customers, vendors, employees, and banking–organized in one place.

Your bookkeeping system should contain all of your transactions including sales, invoices, deposits, and purchases. It should include complete lists of customers, vendors, contractors, and employees as well as the services or inventory items that you produce, manufacture, buy, and sell. Individually each of these items may seem inconsequential. But when you organize them in a bookkeeping system, you can create summary reports that give you valuable insight into many important aspects of your business. Most importantly, these reports help you make important decisions on the future direction of your company.

To ensure that your financial reports are as accurate and valuable as possible, it's important to keep your records up to date. Enter new information on a regular schedule–daily, once a week, or twice a month at least. How often you record transactions depends on how many transactions you have and how much detail you include in your records. As a general rule, the more transactions you have, the more often you need to post them to your books.

A bookkeeping system should be easy enough to use every day. You may need to use your bookkeeping system for very simple tasks such as looking up a price, searching for a customer's last purchase, or seeing how much money you owe a vendor or how much you expect to be paid. And, you will want to run reports regularly to monitor the state of your business's financial health.

2. Understand and tap the power of financial reports.

A key benefit of using a bookkeeping system is that it gives you the ability to easily create insightful summary reports based on complete and up-to-date transaction records. As a business owner, it's vitally important to learn to read and use key reports. Reports give you insight into your business performance and answer questions such as:

- Which invoices are past due?
- How profitable was that big project?
- What will my cash flow be for the next quarter?
- How much did my business grow this year?
- What were my best- and worst-selling products this week?

Assets and Liabilities

Before you begin creating reports, you should become familiar with some essential concepts and terms commonly used to describe the health of any business. Two important terms to learn are assets and liabilities. Knowing the difference between the two will help you effectively use and understand reports.

Simply stated: Assets are what your company OWNS. Cash in your bank account is an asset, along with equipment and other physical property owned by your business. Money your customers owe you, known in accounting as Accounts Receivable, is also an asset, as are patents and trademarks.

Peter Pappas, regional director of the Connecticut Small Business Development Center, warns that growing too fast can often be more detrimental to a new business than growing too slow.

Liabilities are what your company OWES. Outstanding loans and unpaid bills–Accounts Payable in accounting terms–are liabilities. The payroll owed to employees is also a liability. Typically, any obligation your company has to another party is classified as a liability.

Subtract your liabilities from your assets, and you are left with EQUITY. Equity is what the investors in your business–perhaps you chief among them–actually own. If you closed the doors, sold all the businesses assets, and paid off all the debts, what's left over is what you and other investors would receive. It is one important measure of the value and financial health of the business.

Financial Statements

Now you should be ready to learn more about reports. Two of the most important financial reports for you to learn to read and use are the Balance Sheet and the Profit and Loss Statement (P&L). A Statement of Cash Flows is also a key report that shows you the money going in and out of your business.

A Balance Sheet is like a snapshot. It gives you a picture of the financial health of the business at one point in time. The Balance Sheet lists the company's total assets, liabilities, and equity on a particular day. It can be compared to Balance Sheets from prior months or years, allowing you to quickly determine whether your business is improving (or not). The balance sheet is a good indicator of the company's overall financial stability.

On the balance sheet, look for higher assets and lower liabilities, or a proportional growth in assets over liabilities. For example, if you purchased a new truck this year for $30,000 and acquired a loan for $20,000, your assets have increased $30,000 and your liabilities have increased $20,000.

A Profit and Loss Statement is more like a movie than a snapshot. It shows you how the business is doing over a specified period of time. To find out how much money the business made (or lost) last month or last year, you would look at the P&L. This report will tell you, your banker, and your investors whether you're running a profitable business.

Generally what you want to see on a profit and loss statement is growth in revenue: the money taken in from sales, or growth in profit: the money left over after all expenses have been paid. Some companies choose not to grow or choose to cut back on less profitable jobs or projects in order to increase their profit margin.

Peter Pappas, regional director of the Connecticut Small Business Development Center, warns that growing too fast can often be more detrimental to a new business than growing too slow. A new business that tries to expand too fast may not have the resources or reserves–financial, human, and material–to fulfill large projects or numerous simultaneous projects and keep them on time and on budget. So Pappas recommends using key financial reports to monitor cash flow as well as growth rates.

A banker may review your P&L and Balance Sheet to predict the future success of your business, and thereby decide whether to extend commercial credit to help you grow your business. Perhaps more importantly, you can do a better job running a profitable, financially stable business by familiarizing yourself with these reports and how to interpret them.

In addition to the P&L and Balance Sheet, other reports, such as a Statement of Cash

Flows, can help you track the money going in and out of your business. A Statement of Cash Flows presents changes in your company's cash during a specified time period and shows your cash received and cash paid for operating, investing, and financing activities. This report is very useful in helping you make sure your business doesn't run low on operating cash.

3. Plan ahead

While reports from your bookkeeping system show you the current state of your finances, they can also help you predict what's ahead for your business. By investing some time maintaining accurate records and learning to read and use up-to-date financial reports, it is far easier to identify both positive and negative trends in your company's financial health, and respond accordingly.

Neal Nelson, a business analyst at Maricopa College in Phoenix, AZ, who is also a Small Business Development Center advisor, notes that a bookkeeping system is one of the best planning tools a small business can use. For example, reports showing profit margins for every inventory item can help business owners determine if items are priced correctly.

A restaurant owner who came to Nelson for advice had a very popular menu item: sirloin tips. By calculating profit margin by product, the owner realized his sirloin tips only had a gross profit margin (before overhead expenses had been paid) of 15 percent, while his other less popular items had gross profit margins of up to 60 percent.

The owner either needed to raise his prices for the sirloin tips or take them off the menu. Once the owner calculated his margin on his most-popular product, he was able to raise his price accordingly–and boost his bottom line profit.

Nelson notes that, historically, small business owners could succeed by working hard and being friendly. Today, small business owners have to work hard and work smart in order to thrive in an increasingly competitive business climate. Perhaps the most important reason to use a bookkeeping system is that it helps you work smarter. To ensure your long-term success, you need easy access to the detailed information about your business that is easily available through a bookkeeping system.

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Additional Resources and Help

Finally, don't think you have to go it alone to achieve success in your new business. There is no substitute for talking with an accountant, professional bookkeeper, or other business advisor who can help you make the right choices. Even if you just check in with a financial advisor quarterly or at tax time, he or she can offer keen insight based on experience with other small businesses.

Products such as QuickBooks that organize and automate your financial tasks can also offer great benefits. You just fill out familiar forms in QuickBooks, and it does the accounting behind the scenes. QuickBooks can help you keep accurate records and produce critical reports, such as your P&L and Statement of Cash Flows.

If you choose to use QuickBooks, you may want to find a QuickBooks Certified ProAdvisor(SM). These Advisors are independent accountants, bookkeepers, computer consultants and trainers who can help you set up and use QuickBooks. To find an Advisor in your area, visit: www.usequickbooks.com/freehour

In addition, you can find help at your local Small Business Development Center. These Centers, located in more than 900 communities across the U.S., provide consultation, information, and training to help small business owners succeed. To locate one in your area, visit: http://www.sba.gov/starting/sbdclocations.html