



THE SMALL BUSINESS REPORT CARD

Is your business making the grade?

This number-crunching study guide has the answer.



MasterCard
Worldwide

MasterCard Solutions For Small Business

MasterCard® Solutions for Small Business encompasses MasterCard's ongoing commitment to better serve the needs of small businesses. Small business owners need greater control over every aspect of their business. They want solutions to help them run their company better. MasterCard is focused on providing small business owners with “what it takes” to be successful small business entrepreneurs. With access to innovative card programs, value-added services, productivity tools, web-based reporting solutions, rewards and savings on products and services, MasterCard delivers powerful, flexible, and creative payment solutions built specifically with the needs of small business owners in mind. Every solution is backed by advanced technology, unsurpassed global merchant acceptance and the anytime, anywhere reliability of the MasterCard brand. MasterCard is proud to support small business owners and ready to start working for you.

To find out more, visit www.mastercardbusiness.com and click on “Small Business.”

Notwithstanding any provision in any documents available here, you are permitted to download a copy to a computer and make a print copy for internal use.

This material is intended to provide a general overview and does not purport to provide all specific requirements for any person. MasterCard provides this material AS IS for the convenience of its members and cardholders.



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.

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

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.

CONTENTS

	PAGE
ASSET MANAGEMENT	4
① Accounts Receivable Turnover	
② Inventory Turnover	
LIQUIDITY	5
③ Working Capital	
④ Quick or Acid Test	
⑤ Current	
DEBT MANAGEMENT	6
⑥ Leverage (or Debt to Worth)	
⑦ Accounts Payable Turnover Statement	
PROFITABILITY	7
⑧ Profit Margin on Sales	
⑨ Cash Flow to Current Maturities (Debt Service)	
REPORT CARD	8

This material is not intended to provide or take the place of legal or professional financial advice. If you need advice, look for a professional financial manager, consultant, accountant and/or attorney. Design: © NewGround Publications. (Phone: 800 207-3550) Text: © John Nelson & Karen Couto. All rights reserved. Photocopying any part of this book is against the law. This book may not be reproduced in any form, including xerography, or by any electronic or mechanical means, including information storage and retrieval systems, without prior permission in writing from the publisher. 030706

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

$$\frac{\text{Accounts Receivable } (\$75,000 \times 365 \text{ days})}{\text{Net Sales Figure}} = 30.4$$

It takes 30 days to collect bills

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

$$\frac{\text{Inventory of } \$85,000 \times 365 \text{ days}}{\text{Cost of Goods Sold}} = 57.4$$

57 days to turnover or sell the inventory

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)	85,000 C
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)	<u>291,000</u>
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)	<u>291,000</u>

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)	<u>53,000</u>

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.

3 WORKING CAPITAL

FORMULA

$$\begin{array}{l} \text{E Current Assets} \\ \quad \$170,000 \\ \text{F Subtract Current Liabilities} \\ \quad -\$150,000 \\ \hline \end{array} = \begin{array}{l} \text{in Cash, Accounts} \\ \text{Receivable and} \\ \text{Inventory} \\ \$20,000 \end{array}$$

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.

4 QUICK OR ACID TEST RATIO

FORMULA

$$\begin{array}{l} \text{C Total Current Assets of } \$170,000 \\ \text{less Inventory of } \$85,000 \\ \quad \$85,000 \\ \hline \text{F Total Current Liabilities} \\ \quad \$150,000 \\ \hline \end{array} = .56$$

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.

5 CURRENT RATIO

FORMULA

$$\begin{array}{l} \text{E Total Current Assets} \\ \quad \$170,000 \\ \hline \text{F Total Current Liabilities} \\ \quad \$150,000 \\ \hline \end{array} = 1.13$$

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	
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)	<u>291,000</u>
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 F
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)	<u>291,000</u>

Tips for Improving Your Score for Formulas 3, 4 and 5

- Collect Accounts Receivable quicker with a better credit policy (see Formula 1 on page 4)
- Decrease inventory turnover (see Formula 2 on page 4)
- Pay Accounts Payable faster and take advantage of trade discounts (see Formula 7 on page 6)
- Increase profit margins by raising prices and selling more products/services (see Formula 9 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

$$\frac{\text{H Total Liabilities}}{\text{I Total Capital}} = 2.34$$

\$204,000
\$87,000

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.

7 ACCOUNTS PAYABLE TURNOVER

FORMULA

$$\frac{\text{G Accounts Payable at } \$41,000 \times 365 \text{ days}}{\text{J Purchases}} = 42.75 \text{ — 43 days}$$

\$14,965,000
\$350,000

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.*

BALANCE SHEET Year End/As of Dec. 31

Assets	
Current Assets:	
Cash	10,000
Accounts Receivable	75,000
Inventory (ending)	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)	<u>291,000</u>
Liabilities	
Current Liabilities	
Current Portion of Long-Term Debt	6,000
Note Payable	100,000
Accrued Taxes	3,000
Accounts Payable (A/P)	G 41,000
Total Current Liabilities	150,000
Long-Term Liabilities/Loan Payable	54,000
Total Liabilities (150+54)	204,000 H
Capital or net worth	
Owners Investment	20,000
Retained Earnings	67,000
Total Capital	87,000 I
Total Liabilities & Capital (204+87)	<u>291,000</u>

INCOME STATEMENT January 1- December 31

Sales	
Net Sales	900,000
Cost of Goods Sold:	
Beginning Inventory	75,000
Purchases	350,000 J
Labor	200,000
Total	625,000
Less: Ending Inventory	(85,000)
Cost of Goods Sold (625 less 85)	540,000
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)	<u>53,000</u>

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)

$$\frac{\$66,000}{\$6,000} = \$11$$

L Current Portion of Long Term Debt

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

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

BALANCE SHEET Year End /As of Dec. 31	
Assets	
Current Assets:	
Cash	10,000
Accounts Receivable	75,000
Inventory (ending)	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)	<u>291,000</u>
Liabilities	
Current Liabilities	
Current Portion of Long-Term Debt	.6,000 L
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)	<u>291,000</u>

9 PROFIT MARGIN ON SALES

FORMULA

M Net Profit

5.9% profit margin when converted to a percentage

$$\frac{\$53,000}{\$900,000} = .0588$$

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.

INCOME STATEMENT January 1- December 31

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

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	① Accounts Receivable Turnover	4	30.4 days	Good	30 days
	② Inventory Turnover	4	57.4 turns	Good	Match Industry
Liquidity	③ Working Capital	5	\$20,000	Good	Positive Number
	④ Quick or Acid Test	5	.56	Increase	1 or more
	⑤ Current	5	1.13	Increase	2 or more
Debt	⑥ Leverage (or Debt-to-Worth)	6	2.34 times	Good	3 or less
	⑦ Accounts Payable Turnover	6	42.75 days	Decrease	30 days
Profit	⑧ Cash Flow to Current Maturities (Debt Service)	7	\$11	Good	2 or more
	⑨ 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 ① shows how collecting Accounts Receivable faster can produce \$9,000 in extra cash. See page 4.

FORMULA ② Shows how restocking inventory every 30 days saves \$40,257 in expenses. See page 4.

FORMULA ⑦ 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