The Small Business Report Card

Is your business making the grade?
This number-crunching study guide has the answer.

HELPING SMALL BUSINESSES GROW!

Louisiana Small Business Development Center
LEAD CENTER

Louisiana SBDC State Office
700 University Avenue, Admin 2-101
Monroe, LA 71209-6435
Phone: 318-342-5506 • Fax: 318-342-5510
Email: lasbdc@lsbdc.org

REGIONAL CENTERS

LSBDC at Louisiana State University Shreveport
One University Place
Shreveport, LA 71115-2399
Phone: 318-797-5144 • Fax: 318-797-5166
Email: lsbdc.lsus@lsbdc.org

LSBDC at McNeese State University
Burton Business Center, Room 133
450 Lawton Drive
MSU Box 90508
Lake Charles, LA 70609-0508
Phone: 337-475-5529 • Fax: 337-475-5528
Email: lsbdc.msu@lsbdc.org

LSBDC at Northwestern State University
Dunbar Plaza, Suite 114C
3600 Jackson Street Extension
Alexandria, LA 71303-3064
Phone: 318-484-2123 • Fax: 318-484-2126
Email: lsbdc.nsu@lsbdc.org

LSBDC at Southeastern Louisiana University
1514 Martens Drive
Hammond, LA 70401-1656
Phone: 985-549-3831 • Fax: 985-549-2127
Email: lsbdc.slu@lsbdc.org

LSBDC at Southern University Baton Rouge
4826 Jamestown Ave. Suite 1
Baton Rouge, LA 70808-3224
Phone: 225-922-0998 • Fax: 225-922-0024
Email: lsbdc.subr@lsbdc.org

LSBDC at University of Louisiana Lafayette
220 E. St. Mary Boulevard
P.O. Box 43732
Lafayette, LA 70504-3732
Phone: 337-262-5344 • Fax: 337-262-1223
Email: lsbdc.ull@lsbdc.org

LSBDC at University of Louisiana Monroe
700 University Avenue, Admin 2-123
Monroe, LA 71209-6530
Phone: 318-342-1224 • Fax: 318-342-3085
Email: lsbdc.ulm@lsbdc.org

LSBDC Business Continuity Center
at Nicholls State University
310 Ardoyne Drive
P.O. Box 2015
Thibodaux, LA 70301-0001
Phone: (985) 493-2587 • Fax: (985) 493-2588
Email: lsbdc.nic@lsbdc.org

LSBDC Greater New Orleans Region
UNO Jefferson Center
3330 N. Causeway Blvd., Suite 422
Metairie, LA 70002-3573
Phone: 504-831-3730 • Fax: 504-831-3735
Email: lsbdc.gnor@lsbdc.org

LSBDC Technology Center
at Louisiana State University
8000 GSRI Ave, Bldg. 3000
Baton Rouge, LA 70820-7403
Phone: 225-578-4842 • Fax: 225-578-3975
Email: lsbdctc.lsu@lsbdc.org
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.

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.
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**

\[
\text{Accounts Receivable (}$75,000 \times 365 \text{ days)} = \frac{27,375,000}{900,000} = 30.4
\]

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**

\[
\text{Inventory of } 85,000 \times 365 \text{ days} = \frac{31,025,000}{540,000} = 57.4
\]

**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.

### INCOME STATEMENT January 1- December 31

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

### BALANCE SHEET Year End/As of Dec. 31

<table>
<thead>
<tr>
<th>Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
</tr>
<tr>
<td>Accounts Receivable</td>
</tr>
<tr>
<td>Inventory (ending)</td>
</tr>
<tr>
<td>Total Current Assets</td>
</tr>
<tr>
<td>Non-Current Assets</td>
</tr>
<tr>
<td>Fixed Assets</td>
</tr>
<tr>
<td>Less Accumulated Depreciation</td>
</tr>
<tr>
<td>Fixed Assets (net)</td>
</tr>
<tr>
<td>Advances to Owners</td>
</tr>
<tr>
<td>Total Non-Current Assets</td>
</tr>
<tr>
<td>Total Assets (170+121)</td>
</tr>
<tr>
<td>Liabilities</td>
</tr>
<tr>
<td>Current Liabilities</td>
</tr>
<tr>
<td>Current Portion of Long-Term Debt</td>
</tr>
<tr>
<td>Note Payable</td>
</tr>
<tr>
<td>Accrued Taxes</td>
</tr>
<tr>
<td>Accounts Payable (A/P)</td>
</tr>
<tr>
<td>Total Current Liabilities</td>
</tr>
<tr>
<td>Long-Term Liabilities/Loan Payable</td>
</tr>
<tr>
<td>Total Liabilities (150+54)</td>
</tr>
<tr>
<td>Capital or net worth</td>
</tr>
<tr>
<td>Owners Investment</td>
</tr>
<tr>
<td>Retained Earnings</td>
</tr>
<tr>
<td>Total Capital</td>
</tr>
<tr>
<td>Total Liabilities &amp; Capital (204+87)</td>
</tr>
</tbody>
</table>
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

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

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

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.

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 3 on page 6)
• Increase profit margins by raising prices and selling more products/services (see Formula 4 on page 7)
DEBT MANAGEMENT

6 LEVERAGE OR DEBT-TO-WORTH RATIO

**FORMULA**

\[
\text{Leverage} = \frac{\text{Total Liabilities}}{\text{Total Capital}}
\]

\[
\begin{align*}
\text{Total Liabilities} &= \$204,000 \\
\text{Total Capital} &= \$87,000 \\
\text{Leverage} &= \frac{204,000}{87,000} = 2.34
\end{align*}
\]

**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**

\[
\text{Accounts Payable Turnover} = \frac{\text{Purchases}}{\text{Average Accounts Payable}}
\]

\[
\begin{align*}
\text{Purchases} &= \$350,000 \\
\text{Accounts Payable} &= \$41,000 \times 365 \text{ days} \\
\text{Turnover} &= \frac{350,000}{41,000} = 42.75
\end{align*}
\]

**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
  - Accumulated Depreciation: $25,000
  - Fixed Assets (net): $115,000
  - Advances to Owners: $6,000
  - Total Non-Current Assets: $121,000

- Total Assets: $291,000

**Liabilities**

- Current Liabilities:
  - Current Portion of Long-Term Debt: $6,000
  - Note Payable: $100,000
  - Accounts Payable (A/P): $41,000
  - Total Current Liabilities: $150,000

- Long-Term Liabilities/Loan Payable: $54,000

- Total Liabilities: $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

---

**INCOME STATEMENT** January 1- December 31

**Sales**

- Net Sales: $900,000

**Cost of Goods Sold:**

- Beginning Inventory: $75,000
- Purchases: $350,000
- Labor: $200,000

**Total**

- Less: Ending Inventory: $85,000
- Cost of Goods Sold (350 less 85): $265,000

**Gross Profit** (900 less 350): $540,000

**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

---

 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.

---

---
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.

### CASH FLOW TO CURRENT MATURITIES OR DEBT SERVICE RATIO

**Formula**

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

\[
\text{Profit plus Depreciation} = \frac{\text{Net Profit}}{\text{Net Sales}}
\]

**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 $50 per month

### PROFIT MARGIN ON SALES

**Formula**

\[
\text{Profit Margin} = \frac{\text{Net Profit}}{\text{Net Sales}} \times 100
\]

**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.

---

**BALANCE SHEET**

Year End / As of Dec. 31

**Assets**

Current Assets:
- Cash: 10,000
- Accounts Receivable: 75,000
- Inventory: 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: 291,000

**Liabilities**

Current Liabilities:
- Current Portion of Long-Term Debt: 6,000
- Note Payable: 100,000
- Accounts Payable (A/P): 41,000
- Total Current Liabilities: 150,000
- Total Liabilities: 204,000

Capital or net worth:
- Owners Investment: 20,000
- Retained Earnings: 67,000
- Total Capital: 87,000
- Total Liabilities & Capital: 291,000

**INCOME STATEMENT**

January 1 - December 31

- **Sales**: $900,000
- **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: 540,000
- **Gross Profit**: $360,000
- **Expenses**:
  - Operating Expenses:
    - Selling Expenses: 90,000
    - General & Administrative: 170,000
    - Total Expenses: 260,000
  - Interest Expense: 20,000
- **Profit**:
  - Net Profit before taxes: 80,000
  - Less: All Income Taxes: 27,000
  - Net Profit: 53,000

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
## 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 3** 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](http://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

## Report Card

<table>
<thead>
<tr>
<th>Category</th>
<th>Analysis</th>
<th>Page</th>
<th>Book Answer</th>
<th>Comment</th>
<th>Standard</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td>Accounts Receivable Turnover</td>
<td>4</td>
<td>30.4 days</td>
<td>Good</td>
<td>30 days</td>
</tr>
<tr>
<td></td>
<td>Inventory Turnover</td>
<td>4</td>
<td>57.4 turns</td>
<td>Good</td>
<td>Match Industry</td>
</tr>
<tr>
<td><strong>Liquidity</strong></td>
<td>Working Capital</td>
<td>5</td>
<td>$20,000</td>
<td>Good</td>
<td>Positive Number</td>
</tr>
<tr>
<td></td>
<td>Quick or Acid Test</td>
<td>5</td>
<td>.56</td>
<td>Increase</td>
<td>1 or more</td>
</tr>
<tr>
<td></td>
<td>Current</td>
<td>5</td>
<td>1.13</td>
<td>Increase</td>
<td>2 or more</td>
</tr>
<tr>
<td><strong>Debt</strong></td>
<td>Leverage (or Debt-to-Worth)</td>
<td>6</td>
<td>2.34 times</td>
<td>Good</td>
<td>3 or less</td>
</tr>
<tr>
<td></td>
<td>Accounts Payable Turnover</td>
<td>6</td>
<td>42.75 days</td>
<td>Decrease</td>
<td>30 days</td>
</tr>
<tr>
<td><strong>Profit</strong></td>
<td>Cash Flow to Current Maturities (Debt Service)</td>
<td>7</td>
<td>$11</td>
<td>Good</td>
<td>2 or more</td>
</tr>
<tr>
<td></td>
<td>Profit Margin on Sales</td>
<td>7</td>
<td>5.9%</td>
<td>Good</td>
<td>Match Industry</td>
</tr>
</tbody>
</table>