

# 7 TOOLS TO HELP YOU UNDERSTAND YOUR NUMBERS

Taking control of your future and not letting your finances control you. Understanding brings confidence, insight, overview and net profit. We run a series of C.O.I.N Training webinars.

## 1. Cashflow

Operating cash flow offers a bird's-eye view of the economic state of your business. This figure is computed by subtracting your operating expenses from the money your company generates during normal business activities. It includes depreciation to your net income and adjusts for working capital like receivables and inventory. When your operating cash inflow exceeds your cash outflow, this is a sign that you're operating in the black. If the reverse is true, it's time to take a closer look at your income and expenses.

"Sufficient cash flow in your business checking accounts, especially payroll accounts, is critical," "Small-business owners should always make sure they have the necessary cash flow to meet all monthly business expenses." Good accounting software can create charts of inflows (sales of goods or services) and outflows (accounts payable) for your business. It will let you change the time period and other variables so you can really understand what's happening. If you look at these charts over a period of weeks and months, you'll get an idea of the rates of flow of money into and out of your business.





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## 2. Net Income

Closely related to cash flow is your net income, which is also known as your net earnings and net profit. This figure represents the result of subtracting all your expenses, including taxes, from your income. It's not adjusted for items like depreciation. Like cash flow, your net profit is a good indicator of whether you're earning or losing money.

When reviewing expenses, keep an eye on your payroll too, even if you outsource some of it. For a growing company, this is often more complex than anticipated. Review all of these regularly, preferably with the help of your financial strategist, who can act as a sounding board. Remember to keep your personal and professional finances separate: use a separate credit card and bank account for business-related expenses. That makes it much easier to keep track of your company's costs and also identify business tax write-offs.



## Review expenses

It's important to keep a close eye on your business expenditure. Good accounting software will let you quickly draw up useful reports, such as:

1. **Profit and loss reports** - These show your company's income, expenses and profits over time.
2. **Balance sheet reports** - These show assets, liabilities and net equities.
3. **Statement of cash flows reports** - These show the cash flowing in and out of a business.
4. **Accounts payable and accounts receivable reports** - These show how much money is owed by, and to, your company.
5. **Depreciation reports** - These give you a breakdown of the value of the assets owned by your company.



### 3. Profit and Loss

This figure is found on what's commonly known as your P&L statement, which is a snapshot of your company's income (sales and revenue) minus expenses during a specific period of time, which is generally quarterly, every six months or yearly. Knowing your company's profit and loss over time allows you to project earnings and make realistic plans for the future, both short term and long term. Obviously you need the inflows to be greater than the outflows to make a profit. But the size of the difference is what's important. It will vary over time because few businesses make a consistent profit day in, day out. Some months or weeks will be good, some not so good. Looking at the charts will help you see the pattern as these values change. Is the difference between income and expenditure often small? Does it sometimes dip into negative territory? Those are periods when your business is potentially at risk of cash flow problems. Try to find out what's causing this to happen at specific times. You can then attempt to restructure some aspects of your business to avoid the dips.



### Be ambitious but stay realistic

**Ambition and enthusiasm are important characteristics of business owners and managers. But so is the ability to make rational financial decisions based on the facts. When you start a new business the feeling of control can be exhilarating. Free from the constraints of employment, you can make any financial decision you want to. Some of those decisions will be good. Others won't. Like any other area of life, learning to run a business comes through experimentation, successes and occasional mistakes. The mistakes are important - if you read any successful entrepreneur's autobiography or biography, mistakes will feature highly. But successful entrepreneurs have two things in common - they learn from their mistakes, and they make small enough mistakes that they are able to recover from them financially. This is a pragmatic approach to doing business. Few large companies became large overnight. They grew over a period of time, with setbacks along the way. Taking the occasional risk is part of good business. Taking unnecessarily big risks is not.**





## 4. Sales

Given that generating sales is the reason most entrepreneurs operate small businesses, this figure is a given on the critical number's list. Keeping a close eye on sales is important, as a dip could be a warning sign of trouble. In the same respect, it's important to pay attention when sales are up. Determining why business is good at the time your company's on an upward trajectory is easier than trying to figure it out later.

Reacting quickly to an increase in sales also allows you to determine what you need to keep doing to sustain that growth. Sometimes it's preferable to build up a number of smaller clients instead of trying to sign up one or two larger ones. Your cash flow is likely to be more predictable that way. And if one contract ends suddenly, or you experience payment problems, it's less likely to ruin your business.



## 5 questions to ask before bidding for big contracts

**Don't run before you can walk. If your business is ticking over nicely and you're given the opportunity to bid for a big new contract, stop and think first. It can be tempting to "punch above your weight" and go for the prestige associated with a big contract. But that might not be the right choice for you. Ask yourself some questions before you bid.**

- 1. Do I have the staff to fulfil the contract if I win it? If not, will I have to hire new staff or use contractors?**
- 2. Do I have the funds to pay for any new equipment required?**
- 3. What effect will the new contract have on my current business: am I likely to neglect my existing clients?**
- 4. What happens when the contract ends, or if it's terminated early?**
- 5. What happens if the new client takes a long time to pay?**





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## 5. Price Point

"Small-business owners should know exactly how much it will cost them to purchase their goods and then what they'll need to sell those goods or services in order to make a profit." This is an especially critical number for restaurants and other retailers. "When you determine price point, make sure to take into account all overhead expenses, such as utilities, payroll and sales tax."

It will depend on the desirability of the product, the location and visibility of your company, the effectiveness of your marketing and the pricing policies of your competitors. What you can do is experiment. Test different pricing for a week or two, and keep track of how much inventory you manage to sell at each price point. Use good accounting software to compare the revenue and profit from differently-priced products over time. Remember to take into account any seasonal variation, cost overheads and other factors. With some fine-tuning you should be able to get the maximum possible profit from the items you sell.



### **Adjust your margins and get your pricing right**

**What are the margins for the products or services you sell? This can be hard to quantify if you're in the service sector, unless you use sub-contractors to carry out the actual work for you. But it's easier for retailers. Some might simply apply a 50 percent mark-up to their cost prices, and sell an item for \$30 that cost them \$20 to buy. Such basic pricing techniques are attractive for their simplicity, but there are often better alternatives. If you learn about price elasticity, or the price sensitivity of the things you sell, you can price your products or services more accurately. For example, let's say you price an item at \$50 and sell 80 of them in a week. If they cost you \$20 each to buy, the \$4,000 of revenue looks pretty good. But if you priced them at \$30, would you sell 300 of them? Or if you priced them at \$60, would you sell 70 of them? There's no easy answer.**



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## 6. Gross Margin

“Also known as your gross profit—and related to price point—this figure reflects how much money remains after the actual cost of your merchandise is subtracted from the selling price. If this figure is low and not sufficient to cover your operating costs, such as salaries, rent, marketing and utilities, then you're likely not charging enough for your products and services.

Managing your finances and cash flow shouldn't be an afterthought. It should be a fundamental part of your business strategy. To be a successful entrepreneur you must thoroughly understand the numbers that drive your business. That will give you the knowledge you need to keep your company running, and help it to grow when the time is right. Good accounting software will make it easy for you to plan, forecast, chart and chase your company's money. But even with that support, only you can steer your business in the right direction. Good accounting software will break down your accounts in fine detail, so you can see the monetary cost of payments into and out of your business.



### Understand the true cost of money!

The money you receive obviously has value to your business, but so does the money you spend. Getting value for money is important in both directions:

- Pay all your bills on time to avoid being charged interest and negatively impacting your credit score/rating.
- Look into the pros and cons of accepting different payment options such as cash, credit cards, PayPal and other options. Charges for receiving payments will eat into your profit margin, but convenience helps your customers to pay you.
- Research the costs associated with buying or leasing equipment. There could be hidden fees for maintenance or damage, not to mention different effects on your tax bill.
- Save money by educating yourself about tax legislation, insurance requirements and retirement fund financing.
- Consider bartering (trading goods and services) if it will reduce payment costs. But be aware that many countries treat this as a taxable transaction.





## 7. Total Inventory

“Monitor your inventory numbers on a weekly basis to ensure that the amount of inventory isn’t gradually increasing, as this could be a sign of sales trouble. By tracking inventory on a regular basis, you can spot problems early enough to avoid the negative effects of excess inventory, which include storage costs, reduced profits and potential waste.

Understanding your critical financial numbers may not be as exciting as making a big sale, but keeping an eye on these must-know figures will give you precious peace of mind—and a glimpse of what the future holds for your business.

Managing inventory consists of:

- keeping track of goods – where they are and how long you’ve had them
- knowing their value – what they cost and how much they’re selling for
- forecasting demand – learning what sells and ordering accordingly



### **Make minor adjustments to regulate cash flow**

Where possible you should have enough cash on hand to last you approximately three to six months. That way, if you have a rough month or two it shouldn't have a major effect on your business. But if your cash flow is causing problems at specific times of the month or year, don't panic. You may be able to improve the situation without dramatic changes. For example:

- Consider negotiating different payment dates to your suppliers to better align inflows with outflows
- Experiment with reducing your invoicing payment terms by a day or two to encourage your customers to pay faster
- Understand the negative impact of having inventory sitting in your back office or warehouse – it costs you space and revenue
- Establish a good line of business credit so you can access extra short-term money if necessary.



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## About KREA

Krea was set up by entrepreneur Leah Donaldson, to equip and empower small business owners to understand their numbers and look ahead. Krea works alongside owners and staff to cultivate financial confidence. We accomplish this by analysing data and mapping processes to understand what a business is doing then working on where it wants to go. More importantly we make credible recommendations on the financial management, inventory or service system that best suits your organisation.

## Vision

"Cultivating financial confidence, by equipping small business owners to succeed, through customised processes, system integration, training and improved efficiencies, to help you achieve your goals.

**Let KREA help you understand your numbers to increase profits and improve efficiencies.**

## Our Values

### Accountability

We are answerable

### Committed

Keep promises

### Confidential

Private is private

### Fun

Laugh, enjoy and create adventure.

### Innovative

Striving to continuously evolve

### Integrity

We champion a culture of transparency.

### Respect

Value and honour even in our differences

### Teachable

Learning is a permanent condition for us and our clients



# KREA

cultivating financial confidence

**Your trusted business  
partner, creating  
transformational  
change**

**Creating opportunity  
together, to achieve  
intentional success**

## Our Industry experience

**Building/contractors  
& trade services**

**Transport  
distribution and  
logistics**

**Manufacturing**

**Marketing & IT**

**Retail &  
E-commerce**

**Not for Profit**