How Accounting Experts Can Help You Increase Profitability

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Bookkeeping Made Simple

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80% of US Businesses Will Fail Due to Cash Flow Issues

Will this statistic include yours?

In this report, we will discuss common misconceptions about accounting's role in business failure or success, and how to use the services provided by your accountant or bookkeeper to ensure huge business success.

Most business owners manage to take the time to perform monthly bookkeeping, often through an inexpensive outsourced model.

They know that someone must do the grunt work of categorizing transactions and generating financials, but they do not understand what those financial reports are telling them.

They do not see the value in bookkeeping, because they do not understand the power of doing more than compliance – often postponing these critical financial tasks till tax time or until the dreaded IRS letter shows up.

Or worse.

After all, "monthly" bookkeeping is sufficient, or so they think. It will be enough to comply with the law.

If your primary business model is not accounting, are you sure you are even in compliance? Even more importantly, is bookkeeping really where your time is best spent? If you must learn to do bookkeeping, what is the opportunity cost?

Unfortunately, letting these critical financial tasks go undone or done haphazardly can send your business into a death spiral. It's all too easy to let your financial chores get pushed off and ignored until they can't be ignored any longer.

It is difficult to create a plan when your bank account is empty, your credit cards are maxed, and you can't pay your employees, contractors, or vendors.

Dealing with that much stress and anxiety does not do much to help owners think critically and objectively about their businesses.

Creating a strategy based on facts and data can help you avoid loss of business revenue or business failure.

What if it were possible that your bookkeeper / accountant could help you create a more profitable, sustainable business? And what if you could essentially get your bookkeeping service for free? What if hiring a bookkeeper became an investment, not an expense?

What if the way you look at bookkeeping is all wrong?

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What if you can improve your cash flow, grow your business, and know you will be in profit by hiring professionals who can work with you on your books, coach you on your finances, and help you determine where your funds are best allocated for massive business growth?

It is time to take charge of your business and start determining its direction, instead of hoping things will get better. There is an old saying – "If you always do what you've always done, you'll always get what you've always got."

Now the question becomes – what can you do better? If what you're currently doing isn't working for you, what can you change?

The Real Purpose of Accounting

Most business owners don't understand the true purpose of accounting. They think the purpose is to satisfy the government, to file tax returns at the end of the year, or to run payroll. Those are all involved, but only scratch the surface.

Accounting is the practice of organizing, categorizing, and reporting financial transactions. An accountant can help with reporting and interpreting those financial reports to help you determine your financial health. According to Warren Buffett, accounting is the "language of business."

Having and interpreting accurate financial reports is the key to a healthy business. You must both have them and know how to interpret them, or hire someone who does.

Just as a doctor will look at your vital signs to see how healthy you are, an accountant will look at your financial reports to see how healthy your business is, and then discuss with you what your symptoms are and how to improve your business health. And we will help you deal with those very financial tasks that are so concerning for so many. What is the big financial chore that is weighing you down, that you're avoiding even confronting? Also, like in a medical office, we will analyze your business financial symptoms and come up with a diagnosis to improve its health.

Your many business transactions should be organized and reported in a format that is easy to understand.

The most common reports are your income statement, also known as a profit and loss, the balance sheet, and the statement of cash flows. These give you your business income, net worth, and your ability to meet upcoming financial obligations.

> Three important words to pay attention to – organize, report, and decisions.

These accounting reports should help you make sound, strategic decisions regarding the growth of your business.

These decisions typically involve deciding the best way to use business resources to increase business value. Resources are finite, even in massive publicly traded corporations, so it's important to make sure they're invested properly.

Keep in mind, if someone wants to invest in your business, they will nearly always want to see your financial statements. After all, if they want to invest their money in your business, whether through lending or investing, they want to make sure to make sound business decisions themselves.

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Now – how often are you reviewing your reports? Can you make sound business decisions by the seat of your pants? Most people can't. They make decisions, but without reviewing and analyzing their books, they may not be the best ones.

So many business owners do not understand accounting, which is the language of business. Lack of understanding leads to anxiety, neglect, and fear of anything to do with financial accounting.

Lack of understanding puts your whole business at risk.

Accounting Key Insights

There are three critical areas where decisions need to be made according to accounting records.

Budget Allocation – What do you do with your revenues?

Capital Investment – What do you do with "excess earnings"?

Dividends & Owner Draws – What and how much to pay investors and partners.

Let us start with budget allocation.

> A budget is a financial plan that allows you to efficiently use business revenue to generate growth.

Most people hate the term "budget." They lump it in with "diet" on their list of mean, scary words that mean depravation and scarcity. Nothing could be farther from the truth!

Just as a "diet" is an "eating or nutrition plan," a "budget" is a plan for spending. Everyone has a budget. Some folks ignore it, some people spend far in excess of it, and some people use it to gain an advantage in their business, because they already know where every dollar is going. This avoids mismanagement or misallocation of precious resources.

In fact, thoughtful budgeting is critical to creating "excess earnings"!

Of course, with any plan, it can be subject to change, so do not let the idea of planning concern you.

(I know people who will not plan because they do not want to have to change the plan later. There is no such thing as plan that will not change. The prospect for change is an opportunity for growth!)

Budgets start with sales projections. Some accountants advise setting percentages up as allocations, but that does not always work.

For every sale, there are both fixed expenses – office rent, for example – and variable expenses, such as commissions paid to sales staff. Fixed expenses are the same amount every month regardless of what business revenues are. They are also commonly referred to as overhead. Your office rent expenditures are probably not linked to business revenue. Commissions paid to sales staff, the cost of producing a widget, shipping costs, and hourly labor are all variable expenses.

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Following your budget ensures profitability.

So, to determine the sales levels required to reach profitability, it is necessary to figure fixed expenses, and then determine the appropriate percentages of variable expenses.

In other words, how much money needs to come in just to keep the doors open, also called "overhead," and how much is actually tied to the costs of making the sale or producing the products or services?

This will give an initial sales goal. That sales goal gives the starting point for the remainder of the budget.

Of course, no budget fits all businesses. They must be created with the help of the business owner and the accountant. Remember, as the business owner, you ultimately control the finances. You decide where you want your revenues to go. However, to create the business you want, it is critical to allocate resources in alignment with your strategic goals, and then remain faithful to your budget. Doing that will ensure profitability and growth in your business.

What to do with excess earnings?

Many new business owners believe "excess earnings" are a pipe dream. However, when you are successful, it's something that must be dealt with. Like the rest of the financial decisions, there must be a plan in place.

When your profits reach specific benchmarks, it becomes necessary to determine what to do with "excess" earnings. Will you leave it in the business, or reinvest it?

Reinvesting your own money, that of your investors, or business profits is known as "capital reinvestment" and should be an important part of your business plan.

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Increasing capital investment can increase revenue and increase efficiency by decreasing expenses. Some of those expenses might not be obvious. They are decreased by strategic planning and thoughtful resource allocation.

Let's take Amazon as an example. Amazon produces about $200B in revenue each year. Jeff Bezos was announced the richest man in the world in 2018. But how did he get there?

Bezos reinvested nearly 100% of his profits into the business for almost 14 years. Those funds were aggressively invested into advertising, equipment, warehouse space, and so forth. Technically, because Amazon was so aggressive with their reinvestments, they were "unprofitable" for years. If you have wondered how a giant like Amazon can avoid paying taxes, this is one of the strategies they used!

For quite some time, Amazon was Google AdWords' biggest customer – nearly doubling the spending of the next largest advertiser. Increasing their advertising spend this aggressively went a long way towards their growth!

Amazon also invested considerable capital into more products and services, expanding their offerings and revenue streams into Prime, advertising, web services, cloud services, and more. They also acquired Whole Foods as a means of entering the grocery niche.

What does this mean for the small business owner?

While our average client cannot invest $10M a month in advertising spend, Amazon's tactical choices do uncover some interesting strategies any business owner can use to increase growth, such as, yes, increasing advertising and marketing efforts, improving quality and customer satisfaction, investing into new products and services, and even acquiring other businesses.

Business growth is accomplished by increasing market share or expanding into new markets, or both.

It is a simple concept but can be difficult to execute. The decisions that must be made require the information contained in the financial reports if they are to be thoughtful, informed, and strategic in nature.

Your financial reports will tell you what marketing activities yielded the highest return on investment, which services or products generated the most revenue, and how much cash is available for investing. Your accountant can help you determine how to interpret your reports.

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Advertising and Marketing to Fuel Growth

To make informed advertising decisions, the impact of your advertising campaigns must be measured and quantified. You want to create relevant, measurable, and effective campaigns, and those results can be measured on your financial statements.

Effective advertising campaigns will deliver a correlated increase in revenue. If there is not a rise in revenue, then there is a problem.

We can measure the return on advertising spend fairly easily, and then you'll want to identify the marketing activities that yield the highest returns, eliminate campaigns that yield low returns, and make the most effective use of your advertising dollar.

Customer Satisfaction Fuels Growth

Back in the 1980s, Coke and Pepsi were embroiled in what were known as the Cola Wars. Coke had the lion's share of the market, while Pepsi was still trying to make inroads.

Pepsi developed a genius advertising campaign, using "The Pepsi Challenge" taste test. Because Pepsi is sweeter than Coke, the taste test was weighted in Pepsi's favor.

Coke decided to do the unthinkable – instead of continuing to use their 100-year-old secret recipe, they reformulated and came up with New Coke. They also spent millions on an advertising campaign to roll it out.

The problem was no one liked New Coke. It tasted too much like Pepsi. The biggest gamble of the Coca-Cola Company was a huge flop.

All the marketing in the world could not save it.

If you do not provide a product or service that people wish to buy, everything else fails.

If you fail to satisfy your customers, they will then tell their friends, family, and social media, they will write bad reviews, and your business will feel the heat.

Therefore, it is critical to make sure your customers are happy with what you're selling them. No matter how good you think you are, you need to improve your customer satisfaction and value. You can have the best product in the world and still fail to take off if you irritate your customers or fail them in any way.

It may cost more to determine customer satisfaction, and to restructure the way your goods and services are delivered, but the payoffs are enormous.

You will need to determine your key performance indicators (KPIs), such as perceived value and actual value, and continually assess them.

People make purchasing decisions based on perceived value.

Actual value will determine continuing, repeat business and referrals. Reputation and reviews can also be impacted if there is a failure to deliver, which will influence new customers. Customer satisfaction is one of the most important sections of your business.

To measure customer satisfaction, surveys, feedback forms, and interviews are often used. The results are aggregated and evaluated continually to measure staff performance, and deficiencies immediately addressed.

This data is considered "non-financial" but remains a critical KPI. It may not appear on the financial reports, but it impacts the bottom line, nevertheless. Therefore, all KPIs must be identified and monitored continually to make sound business decisions.

New Products, Services, or Industries

What do you do when you have maxed out your market, or want to grow faster?

Mr. Clean extended their lines of cleaner.

You may decide to make capital investments into new product and service offerings.

To make these decisions, you will need to rely on financial metrics. A good place to start is by examining your income statement in detail to identify the most profitable product or service lines you offer. Then decisions can be made as to which lines can be expanded upon.

You might also decide to allocate resources to demographics similar to your most valuable customers.

Either way, your financial information will help you with your decision-making process. External information, such as independent market research, can also help make good decisions.

Mergers and Acquisitions

Using mergers and acquisitions to grow is extremely complicated and beyond the scope of this report, but it is a common strategy.

Financial statement analysis of both entities allows the executives to use sound judgement in determining whether, and how, to merge or acquire firms to drive business growth.

Increasing Efficiency

Sometimes, you need to spend money to save money. As anyone who has bought a new car to replace an old "beater" car that had no payment, but cost a fortune in tow fees, repairs, and poor gas mileage can tell you, sometimes spending results in savings.

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Yes, from time to time you need to invest capital into streamlining, increasing productivity, and facilitating a smooth operation in your business. This may involve purchasing new equipment, revamping and retraining employees, or eliminating unproductive expenses.

We can look at your financial statements and see if investing capital into infrastructure will make sense for your business. Is it time for new facilities, equipment, training?

We can also look at inventory. Is it turning over fast enough? Are you dealing with spoilage or shrinkage? Letting inventory sit unsold is a waste of resources.

Are you spending advertising dollars that are not turning into revenue? Does your advertising budget need to be reassessed?

How quickly are your customers paying their invoices?

Your financial statements can answer all these questions regarding efficiency and more. We can apply specific ratios to see where your business currently is in terms of liquidity, activity, and profitability, and help you determine where you should invest to improve your efficiency.

Liquidity ratios measure the available cash of your business, often compared to liabilities to see how easily your company can meet its short-term obligations. High liquidity means there is plenty of cash to meet obligations, while low liquidity can mean the opposite and that swift action may be needed to prevent bankruptcy.

Activity ratios measure the ability of a company to convert assets into cash or sales. The are often the “turnover” ratios and answer the questions, how quickly do your invoices get paid by your customers? How quickly do you need to replace inventory (because it sold)? And how quickly are you able to pay your debts?

Analyzing the activity ratios in conjunction with liquidity information can help improve cash flow.

The profitability ratios measure the company’s ability to generate earnings relative to expenses. Many business owners attempt to judge their businesses by total sales, which really does not indicate whether the business is making money. Other business owners will attempt to determine profitability by bank balances, which also does not help determine whether the business is in profit, as so many small business owners commingle funds.

The number one profitability ratio is the profit margin. It tells how the business is handling its finances overall and is always expressed as a percentage. This is one ratio that every business owner should know as it directly impacts the amount of money available to pay investors, including themselves.

The other three important profitability ratios are return on assets, return on equity, and return on investments. All three ratios measure profitability in relation to assets, equity, and investments, all of which should be used to help your business increase earnings. A high ratio across these three shows how well your business is accomplishing this.

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Using Financial Statement Analysis to Measure Business Efficiency

Your financial statements are truly the key to understanding your business health. When you develop a budget, you then measure your actual expenditures against that proposed budget, then measure your performance and see what it means for your business. You use the ratios discussed above to determine the health of your business, and to see where you need to make strategic decisions to improve business health and profitability.

Interestingly, most accounting firms don't go into these details with their clients.

If you have read this far, you have learned how to use budgets to guarantee profitability, and how your financial reports and accountant can help guide your capital investments.

Now you can reap the fruit of your labors and receive disbursements from your business.

Many business owners will take a paycheck from their business in the ordinary course of doing business, which is completely fine. It is important to do this to measure the actual cost of labor, which can't be quantified unless everyone working in the business receives a paycheck for wages earned.

What we are referring to here is referred to as distributions, guaranteed payments, or owner draws, depending on how your business is structured.

By now you should understand that there is a formula for determining payouts to yourself and investors.

Working Capital

Consider your working capital – how much cash do you need to operate? You do not want to deprive your business of needed cash.

You need to balance business interests against personal interests. After all, you are in business, we hope, to make money for yourself.

And you need to think about the tax implications of business compensation. These will vary based on the type of entity you own, how you take your distributions, and how much you take out.

Let's start with working capital, or the amount of money your business needs to continue operations. To figure this, subtract liabilities from current assets, which gives working capital, and then subtract working capital from current assts, which is the MOST you can withdraw from your business without injuring its ability to meet its obligations.

It is good practice to leave enough cash in working capital to cover not only regular operational expenses, but also unexpected expenses that may arise.

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Balancing Personal vs Business Interests

When funds are withdrawn from the business, there are opportunity costs to consider. If you take too much money out, you will not be able to grow your business as aggressively as you might like. However, if you are too aggressive in reinvesting capital, you may go a lifetime without every paying yourself!

You will want to carefully consider both aspects of dividend payouts and come up with a plan to balance both personal and business needs.

Tax Implications

Any time money is involved, taxes are involved in some way as well. There is a reason for the old saying, "Nothing is certain but death and taxes." So, when you are deciding how much to withdraw from your business, you will need to consider how it will affect your tax burden.

Tax liabilities can be mitigated by reinvesting into tax deductible activities to grow your business.

When it comes to owner draws and dividends, tax liability will vary depending on the type of entity you own. Corporations, LLCs, partnerships, and sole proprietorships are all taxed differently, and that will play into the tax implications of withdrawing funds.

Your accountant should be able to discuss with you the tax implications of various entities and how to plan for upcoming tax bills and tax changes.

We hope you close this report with an understanding of how financial and managerial accounting can help your business grow.

Most successful businesses that end up failing do so due to mismanagement of funds – which is due to lack of information, guidance, and coaching. They simply run out of cash.

When you understand that accounting can do more than balance your checkbook and help you file a tax return, you can unleash its power to help your business maximize its potential.

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