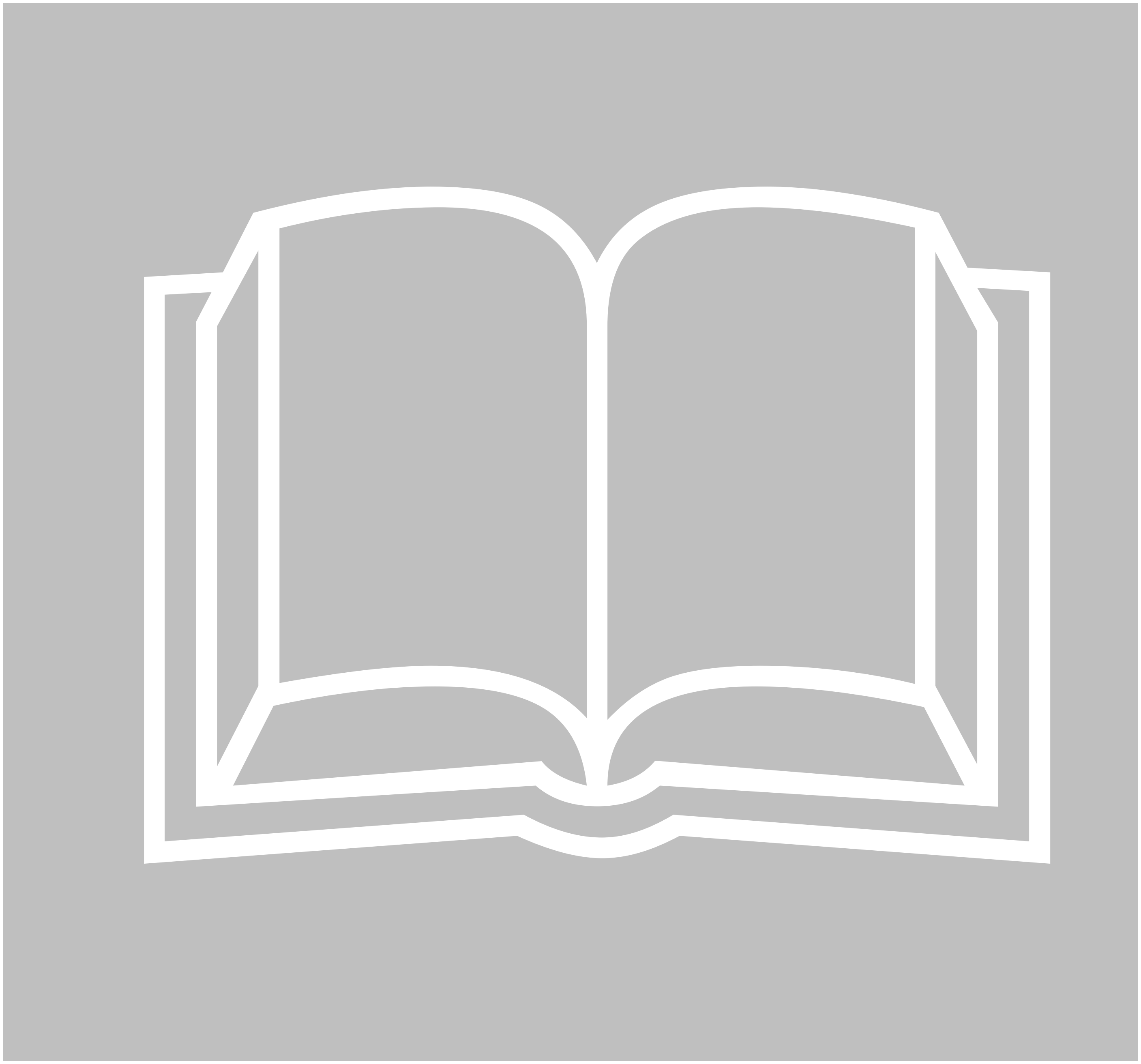
Guide To Starting A Business



Growing Your Business

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INTRODUCTION

Small businesses often fail because owners are unaware of the many elements that can prevent the business from growing and being successful. Often, small businesses are organized around the manager's specific area of expertise, such as marketing, accounting or production. This specialized expertise often prevents the business owner from recognizing problems that may arise in other parts of the business.

This guide will provide you with the essentials for conducting a comprehensive search for existing or potential problems. It's designed with small businesses in mind and addresses their unique problems and opportunities.

Knock! Knock! Who's there? OPPORTUNITY!

DESIGNING THE AUDIT

As the first step in determining what small businesses need to know, many small businesses use consultants to help them obtain essential information for conducting many of their business affairs. Consultants are used for basic planning, general business practice, accounting, finance and loan procurement, advertising and promotion, market research, feasibility studies and operations.

This tool is not a replacement for good management skills. Audits and handbooks cannot do a consultant's job; however, effectively designed instruments, such as this tool, can save valuable time for the seasoned as well as the novice small business manager.

In order to gain maximum effectiveness from this tool, the small business manager should answer all questions in the audit, with an affirmative answer indicating no problem and a negative answer indicating the presence of a problem in a specific area.

After completing the audit, the manager can review the analysis of each section of the audit that follows to determine what action is most appropriate. The audit analysis provides an overview of how the various elements of the audit are related. The seven critical business functions -- basic planning, general bookkeeping and accounting practices, financial planning and loan proposals, sales and marketing, advertising and promotion, personnel and production -- under three major audits: the management audit, the operations audit and the financial audit, as outlined in Figure 1.

In the healthy and financially sound small business, these seven functional areas are in balance. In many cases, one cannot work on all seven areas at once. The manager must decide which area to concentrate on based on past practices and the needs of the business. Regular use of this audit instrument can help make the small business manager more efficient. See Exhibits A, B, and C. Exhibits D, E and F are examples that provide guidance to Exhibits A, B, and C.

Figure 1
Audit Checklist for Growing Businesses

THE MANAGEMENT AUDIT
- Basic Planning
- Personnel

THE OPERATIONS AUDIT
- Production
- Sales and marketing
- Advertising and promotion

THE FINANCIAL AUDIT
- General bookkeeping and accounting practices
- Financial planning and loan proposals

This methodology helps the small business manager to critically assess the strengths and weaknesses of all facets of the business. By using the management audit instrument and the audit analysis on a regular basis, the small business will be better able to see pitfalls in sufficient time to react appropriately, thus ensuring a greater possibility of business survival and prosperity.

Exhibit A - The Management Audit

	Yes	No
I. Basic Planning		
A. The company has a clearly defined mission.	____	____
1. There is a written mission statement.	____	____
2. Company is carrying out the mission.	____	____
3. Mission statement is modified when necessary.	____	____
4. Employees understand & share in the mission.	____	____
B. The company has a written sales plan.	____	____
1. Market niche has been identified.	____	____
2. New product lines are developed when appropriate.	____	____
3. Targeted customers are being reached.	____	____
4. Sales are increasing.	____	____
C. The company has an annual budget.	____	____
1. Budget is used as a flexible guide.	____	____
2. Budget is used as a control device.	____	____
3. Actual expenditures are compared against budgeted expenditures.	____	____
4. Corrective action is taken when expenses are over budget.	____	____
5. Owner prepares budget.	____	____
6. The budget is realistic.	____	____
D. The company has a pricing policy.	____	____
1. Products or services are competitively priced.	____	____
2. Business provides volume discounts.	____	____
3. Prices are increased when warranted.	____	____
4. There is a relationship between pricing changes and sales volume.	____	____
5. New prices are placed on last-in goods when the price on old stock gets changed.	____	____

II. Personnel

A. Employees know what is expected of them. ____ ____

1. Each employee has only one supervisor. ____ ____
2. Supervisors have authority commensurate with responsibility. ____ ____
3. Employees volunteer critical information to their supervisor. ____ ____
4. Employees are using their skills on the job. ____ ____
5. Employees feel adequately trained. ____ ____

B. Each employee has a job description. ____ ____

1. Employees can accurately describe what they do. ____ ____
2. Employees do what is expected. ____ ____
3. Work load is distributed equitably. ____ ____
4. Employees receive feedback on performance. ____ ____
5. Employees are rewarded for good performance. ____ ____
6. Employees are familiar with company policies. ____ ____
7. There is a concise policy manual. ____ ____

C. Preventive discipline is used when appropriate. ____ ____

1. Employees are informed when performance is below standard. ____ ____
2. Unexcused absences are dealt with immediately. ____ ____
3. Theft prevention measures are in place. ____ ____

D. Regular employee meetings are conducted. ____ ____

1. Employees' ideas are solicited at meetings. ____ ____
2. An agenda is given to employees prior to the meeting. ____ ____

Exhibit B - The Operations Audit

		Yes	No
I. Production			
A.	The company has a good relationship with suppliers.	____	____
1.	A well-documented plan addresses how to deal with suppliers.	____	____
2.	Inventory delivery times are specified.	____	____
3.	Levels of quality of materials and services are specified.	____	____
4.	Payment terms are documented.	____	____
5.	Contingency plans are provided.	____	____
6.	Regular contact is made with suppliers.	____	____
B.	The company provides for good inventory control.	____	____
1.	Company has an inventory control formula to provide for optimum inventory levels.	____	____
2.	Company has a policy on securing inventory in a timely fashion.	____	____
C.	The company conducts incoming inventory inspections.	____	____
1.	Company has a written policy on incoming inspection.	____	____
2.	Incoming inspection is being performed.	____	____
3.	Incoming inspection levels of quality are documented.	____	____
D.	The company has alternate sources of raw materials.	____	____
1.	Two or more suppliers are identified for each product needed.	____	____
2.	Majority of raw material requirements are divided equally between two major suppliers with a third source receiving lesser but consistent orders.	____	____

E. The company has a routine maintenance program. ____ ____

1. A routine maintenance program is documented and communicated to all maintenance personnel. ____ ____
2. Every major piece of equipment has a maintenance log positioned in an obvious place. ____ ____
3. Preventive maintenance is a regular occurrence. ____ ____

F. The company has a formal operator training program. ____ ____

1. Company has a written operator training manual. ____ ____
2. A progressive training process is in place. ____ ____
3. Accomplished operators are identified to answer questions from trainees. ____ ____
4. Constructive feedback on training progress is provided in a nonintimidating fashion. ____ ____

G. The company meets Occupational Safety and Health Administration (OSHA) standards. ____ ____

1. Company is aware of OSHA standards pertaining to the business. ____ ____
2. Company conducts regular meetings with employees concerning OSHA standards. ____ ____
3. All safety records and lost time accidents are documented. ____ ____

H. The company has a well-documented processing procedure. ____ ____

1. A scheduling process enables orders to be grouped for more efficient processing. ____ ____
2. A scheduling chart allowing instantaneous recognition of production status is in an obvious place. ____ ____
3. Subassemblies are manufactured in sufficient quantities on a timely basis. ____ ____
4. Finished stock is safely transported to a clean and dry area. ____ ____
5. Adequate controls are provided to preclude excessive inventory buildups that could result in finished stock spoilage or obsolescence. ____ ____

I. The company has an environmental awareness policy. ____ ____

1. A policy pertaining to the disposition of hazardous waste materials is fully documented and communicated to all pertinent parties. ____ ____
2. Attempts are made to stay current with all existing regulations pertaining to the environment. ____ ____
3. Regular meetings are conducted to determine better methods of dealing with by-products. ____ ____

J. The company attempts to stay current with technological advances. ____ ____

1. Company representatives attend trade shows on a regular basis. ____ ____
2. Company subscribes to trade publications. ____ ____
3. A formal employee suggestion program is in place. ____ ____
4. Company conducts regular technology advancement brainstorming sessions involving the employees. ____ ____
5. Company is involved in the community's extended learning programs. ____ ____

II. Sales and Marketing

A. The owner knows exactly what the business is. ____ ____

1. The owner knows exactly who the customer is. ____ ____
2. Potential customers know about the business. ____ ____
3. Location is appropriate for the business. ____ ____
4. The market is clearly defined. ____ ____

B. The owner knows competitors and their location. ____ ____

1. The owner knows how his or her prices compare with the competitions'. ____ ____
2. The owner knows how the competition is regarded. ____ ____
3. Census data are used for strategic marketing. ____ ____
4. The owner knows the county sales patterns. ____ ____

C. The owner and employees focus on customer needs. ____ ____

1. The owner and employees treat customers courteously. ____ ____
2. The customer's concerns, complaints and suggestions are listened to carefully. ____ ____
3. Customers are provided with quick, reliable service. ____ ____
4. The owner is considered knowledgeable by customers. ____ ____
5. Appropriate housekeeping procedures for the business are followed. ____ ____

D. The owner is aware of customer needs. ____ ____

1. Feedback is requested from customers. ____ ____
2. Sales receipts are monitored. ____ ____
3. Sales receipts are compared to those from previous years. ____ ____
4. Seasonal variations are taken into account. ____ ____

E. The company needs to increase sales volume. ____ ____

1. There is a sales plan in effect. ____ ____
2. Sales goals are being met. ____ ____
3. Effective sales presentations are being made to potential customers. ____ ____
4. Names of prospects are kept in a follow-up file. ____ ____
5. Sales are closed effectively. ____ ____

III. Advertising and Promotion

A. The owner has an advertising and promotion plan. ____ ____
The business

1. Has an advertising budget. ____ ____
2. Advertises monthly. ____ ____
3. Advertises weekly. ____ ____
4. Has a promotional calendar. ____ ____

B. The owner uses effective advertising and promotion. ____ ____

1. Advertises in the Yellow Pages. ____ ____
2. Uses newspapers and shoppers. ____ ____
3. Uses radio and television advertising. ____ ____
4. Obtains no-cost or low-cost media coverage. ____ ____

C. The owner uses effective merchandising techniques. ____ ____

1. Relates display space to sales potential. ____ ____
2. Uses vendor promotional aids. ____ ____
3. Knows traffic flow patterns of customers. ____ ____
4. Keeps facilities clean. ____ ____

D. The owner evaluates advertising and promotional efforts. ____ ____

1. Determines if sales increase with advertising. ____ ____
2. Ascertains if sales increase after special promotions. ____ ____
3. Finds out whether advertising is reaching intended market. ____ ____

Exhibit C - The Financial Audit

	Yes	No
I. General Bookkeeping and Accounting Practices		
A. The company has a bookkeeping system.	____	____
single entry _________ double entry _________		
1. Prepares the books.	____	____
a. Understands the how and why.	____	____
b. Prepares own financial statements.	____	____
2. Pays for bookkeeping service.	____	____
a. Understands financial statements.	____	____
b. Has taxes done by bookkeeper.	____	____
c. Has compared cost for bookkeeper with that of a CPA.	____	____
B. The company reconciles bank statements monthly.	____	____
C. The company keeps income and expense statements accurate and prepares statements monthly.	____	____
1. Understands purpose of financial statements.	____	____
2. Compares several monthly statements for trends.	____	____
3. Compares statements against industry averages.	____	____
4. Knows current financial status of business.	____	____
D. The company makes monthly deposits for federal withholding and Social Security taxes.	____	____
1. Understands Form 941.	____	____
2. Makes deposits on time to avoid penalties.	____	____
3. Provides W-2 information.	____	____
E. The company has a credit policy.	____	____
1. Ages billing system monthly.	____	____
2. Accesses late payment fee from customers.	____	____
3. Writes off bad debts.	____	____
4. Has good collection policies.	____	____
5. Has a series of increasingly pointed letters to collect from		

late customers. ____ ____

6. Has VISA, MasterCard, or other credit card system. ____ ____
7. Emphasizes cash discounts. ____ ____

F. The company files all tax returns in a timely manner. ____ ____

1. Considers tax implications of equipment early. ____ ____
2. Considers buy versus lease possibilities. ____ ____
3. Considers possible advantages/disadvantages of incorporation/Subchapter S. ____ ____
4. Does not pay tax penalties (federal, state, sales). ____ ____

II. Financial Planning and Loan Proposals

A. The company has adequate cash flow. ____ ____

1. renumbered cash receipts are monitored and accounted for. ____ ____
2. Checks are deposited properly each day. ____ ____
3. Customer invoicing is done promptly (within two working days). ____ ____
4. Collections are received within 60 days. ____ ____
5. Accounts Payable takes advantage of cash discounts. ____ ____
6. Disbursements are made by pre-numbered check. ____ ____

B. The company projects cash-flow needs. ____ ____

1. Payrolls are met without problems. ____ ____
2. Money is set aside for expansion, emergencies and opportune purchases. ____ ____
3. Short-term financing is used when needed. ____ ____
4. Line of credit is established with a bank. ____ ____

C. The company understands the role of financial planning in today's highly competitive lending markets. ____ ____

1. The owner's personal resume is prepared and current. ____ ____
2. Personal financial statements have been prepared. ____ ____
3. The business has a written business plan. ____ ____
4. Source and use of funds statements exist for the past two years, with a projection for the next two years. ____ ____
5. An accurate balance sheet exists for the past two years and includes a projection for the next two years. ____ ____

6. The owner has a good working relationship with a banker. ____ ____

7. There is a strong debt-to-equity ratio (1:2/1:1). ____ ____

Exhibit D - Management Audit Analysis

I. Basic Planning

A. Company (Business) (Owner) has a clearly defined mission.

What business are we in; is a question that created a major problem for many of the cases analyzed by the authors. Too often owners/managers cannot communicate their vision to customers, employees and/or bankers because they don't have a vision. To make a profit or to provide myself employment is not an operational answer to the question, although these may be true statements and may be the reasons the owner(s) went into business in the first place. A good mission statement tells why the business exists and defines its market niche. The mission statement is the foundation, upon which the business is built. Like a good foundation, it need not be fancy, but it must be solid.

1. There is a written mission statement.

This is an essential element of a good loan application. Written mission statements are also useful for communicating to customers, employees and suppliers. They are the backbone of strong marketing and promotion efforts.

2. Company is carrying out the mission.

If a company cannot execute its mission, it is probably losing money and certainly not maximizing profits. If it is not accomplishing its mission, the owner-manager must ask why. Maybe the mission is unrealistic. Possibly the competition is doing a better job of accomplishing that same mission.

3. Mission statement is modified when necessary.

Often a realistic change of mission can turn a losing business into a profitable one. An example of this is a restaurant that redefined its mission as that of a catering service, thereby accomplishing the owner's personal goal of making a good living.

4. Employees understand and share in the mission.

Confused employees, pilferage and poor customer relations are the result of employees who do not understand the mission of the business and how they fit into it. A clear mission shared with employees results in high employee morale and efficient operations.

B. Company has a written sales plan.

A written sales plan is essential for an effective marketing effort. It provides specific direction for the business and it is inextricably linked to marketing success. The plan should detail sales goals by month and describe the specific efforts to be undertaken to ensure that those goals are reached. Pricing policies should be a part of the plan, along with a brief description of product distribution channels. The most compelling reason for sales planning is that it is essential to sound cash-flow management.

1. Market niche has been identified.

Very few business opportunities are new and original. Because of this, it is essential for small businesses to find an appropriate, unique market niche to be successful. The niche they fill may have to do with the service provided, its quantity or quality, the personal attention to customers' needs or simply the business location. Analysis of the SBI cases showed that many of the more successful businesses had defined their market niche by their location.

2. New product lines are developed when appropriate.

All products and services eventually become obsolete. Keeping in touch with your customers' tastes and preferences and your changing market characteristics is essential for survival. Obtaining feedback from current customers often leads to new product or service ideas. Well-placed suggestion boxes or market surveys provide more systematic means of gathering such information.

3. Targeted customers are being reached.

It is important to reach the intended customers. Quite often sales can go up, but will not bring in extra profits. Not all customers are equal. Some customers cost more to service than others because of their distance from the primary place of business or because of their unique needs.

4. Sales are increasing.

If problems exist, they may be due to pricing structure, change in market demands, new competition, poor quality of product or service, poor or inadequate advertising or planning, problems with personnel or market saturation.

C. Company has an annual budget.

The annual budget is the simplest means of directing and controlling a small business. It is the one planning tool essential for effective operation. The annual budget links the business plan to business reality because it not only projects the business's direction, but is a means of tracing the flow of money into, through and out of the business and helps the owner determine how to use scarce resources. By comparing actual results with projections, the owner is able to evaluate the effectiveness of various business activities. Not having and not using a budget is a common reason for cash flow problems and subsequent business failures.

1. Budget is used as a flexible guide.

The budget does not represent business reality -- it is merely a map describing where the business is going. A major mistake that often occurs with the budgeting process is thinking that money allocated to certain expenditure actually exists in the bank. Effective business owners constantly check the budget against operational reality and make changes in the budget as needed. Flexible budgeting in response to actual business performance is the mark of a shrewd businessperson. Too rigid adherence to the budget often leads to poor profit performance and even bankruptcy.

2. Budget is used as a control device.

Controlling expenditures is essential if a profit is to be realized. The budget is the single most important device available for monitoring and controlling expenditures. Any business will eat up resources.

3. Actual expenditures are compared against budgeted expenditures.

   Monthly and annual expenditure comparisons must be made for both control and flexibility purposes. It is the only way critical decisions and corrective actions can be planned and then taken. If the owner-manager is constantly putting out fires, monthly comparisons are not being made nor are timely corrective actions being taken.

4. Corrective action is taken when expenses are over budget.

   Most small businesses get into financial trouble because they do the right thing too late. Taking timely corrective action is the mark of an effective business owner-manager.

5. Owner prepares budget.

   An excellent budget prepared by an employee or accountant is virtually useless if the owner is not committed to it. Budget preparation educates the owner to the realities of the business. Looking at a budget prepared by another does not educate the viewer. When the owner has someone else prepare the budget, the control of the business has been delegated to that person.

6. The budget is realistic.

   The budget must be based on a realistic appraisal of the business environment. Not taking the budgeting process seriously and dreaming about what one wants to see is a sure sign of business failure. Realistic budgeting is a time-consuming and demanding process, but it is the most effective tool at the owner's disposal for accomplishing financial objectives.

D. Company has a pricing policy.

Pricing goods and services is one of the most difficult problems confronting the small businessperson. Much has been written on break-even analysis as a rational means of determining prices and pricing policy. Too often the owner-manager looks at his or her competitors and charges a fraction more or fraction less than they do. This haphazard approach to pricing has been the ruin of many small business operations. A well-written mission statement, a unique market niche and a detailed budget will help guide the owner-manager through the pricing jungle. An effective pricing policy can be determined only after the owner has decided specifically what the business is, how it differs from the competition and what the cash flow needs are. Pricing should be determined through history and mission, not by accident.

1. Products or services are competitively priced.

   Who is the competition? What is competitive? On the surface these queries look easy, but analysis of the SBI cases demonstrated that few owner-managers knew who they were competing against. For example, a small hardware store is not competing with the chains, but with other small hardware stores that offer the same products and services. Services

are harder to price than goods. It is difficult for the buying public to determine the fair price for
services, and comparative shopping has much less effect in service industries than it does in hard goods industries. A close look at pricing policies can often move a business from red ink to black, but this is a time-consuming activity area for the owner-manager.

2. Business provides volume discounts.

   Volume discounts are essential for large volume purchasers of goods and services. Clear volume discount policies save valuable time when dealing with customers and can even give the small business a competitive advantage.

3. Prices are increased when warranted.

   Random price increases can drive away business and destroy goodwill. However, when the budget projections warrant, it is essential to make the increases. Waiting too long to increase prices can literally destroy a small business. This is another reason monitoring the budget is essential.

4. There is a relationship between pricing changes and sales volume.

   If there is no direct relationship between pricing changes and sales volume, the sale of a product or service is relatively independent of its cost. When this is the case, either the market is saturated or the owner-manager should put a major effort into advertising and promotion.

5. New prices are placed on last-in goods when the price on old stock gets changed.

   This should be obvious. When this is not being done, it is usually an indication that good general business practices are not being followed. Other than planning, poor general accounting and bookkeeping practices were found to be the major cause of financial problems for the small business cases studied.

II. Personnel

A. Employees know what is expected of them.

Surprisingly, many employees do not know what is expected of them. This appears to be true even when the employees are family members. In the SBI cases that dealt with personnel problems, this was also the case. Poor communications can result in arguments, hurt feelings and poor performance. Despite all that has been written on the importance of good communications in business, it is still a major problem.

1. Each employee has only one supervisor.

   In most of the SBI cases that dealt with personnel issues, the major problems occurred when employees did not know who their boss was. The owners also were very confused about who reported to whom. A simple organizational chart can quickly solve this problem. It is important that every employee have only one boss; two bosses often make contradictory demands that make it impossible for the employee to do either job effectively. This creates ill will and destroys teamwork and productivity.

2. Supervisors have authority commensurate with responsibility.

   Too often a supervisor has responsibility without the proper authority. This undermines the supervisor and confuses the employees. When owners do not delegate the necessary authority, they destroy their own profits. Often the ability to delegate authority properly has not been learned by small business owners. The cause of poor delegation is often simply the result of poor planning. Clearly thinking through the mission and purpose of the business and establishing achievable goals is an important part of delegating effectively.

3. Employees volunteer critical information to their supervisor.

   When employees volunteer critical information to supervisors, it indicates the presence of trust between employees and management. When critical information is not volunteered and the owner is blindsided by unexpected problems, it becomes essential for the owner and supervisors to work on developing trust. Sharing information and asking for feedback are two very simple things the owner can do to improve communication and productivity in the business.

4. Employees are using their skills on the job.

   Employees who have skills that are not being used are a wasted resource that the businessperson cannot afford to lose. Too often employees are not being used effectively because the owner is poor at communicating and especially poor at listening. Employees who are not contributing but have the skills to do so also become a morale problem and cause other employee problems.

5. Employees feel adequately trained.

   Too many of the employees in the SBI cases did not have adequate training to do their jobs. The causes were numerous, but one major cause ironically had to do with a too-rapid growth of the business. Another major problem was poor hiring -- the owners lacked knowledge about what was required to do the job effectively.

B. Each employee has a job description.

Most of the companies in the study did not have job descriptions for employees. A good job description simplifies hiring, placement and training of employees and improves communication. It is impossible to have a good job description if the owner has not done a good job of planning.

1. Employees can accurately describe what they do.

   Being able to communicate what one does at work is essential to effective job performance. It develops pride, increases motivation, reinforces high performance and simplifies decision making.

2. Employees do what is expected.

When employees are not doing what is expected, it is generally the owner's fault, and it is a sure sign of poor communication. Often employers cannot communicate their expectations because they don't know what is expected either. This problem can be solved only by effective planning and communication.

3. Work load is distributed equitably.

   The perception of inequitable work loads destroys morale and productivity. Good planning, clear job descriptions and effective communication will go a long way toward ensuring equitable work loads in a business.

4. Employees receive feedback on performance.

   Without feedback an employee cannot change or even know that change is required. Feedback does not cost the owner anything, and it is the single most powerful tool available for improving poor performance.

5. Employees are rewarded for good performance.

   Rewarding employees for good performance-- whether financially or simply verbally -- is the best way to obtain quality performance. However, if the owner doesn't know what good performance is, there is no way to reward it.

6. Employees are familiar with company policies.

   Too often policies are in the owner's head and are not written down and distributed to employees. This creates numerous problems for both the owner and employees. There is only one solution. Policies must be written and owners must make certain that employees understand them.

7. There is a concise policy manual.

   Manuals must be short, simple and understandable. Massive policy manuals accomplish nothing because they are unusable. Having no policy manual, on the other hand, is also a problem. Stacks of papers that aren't easily found or policies that are not written down put the employee in an impossible situation. Good policies that meet the needs of the business simplify decision-making and lead to smoother operation.

C. Preventive discipline is used when appropriate.

Too often, the owner wants to be a nice person and avoids discipline when it is needed. Preventive discipline can take place only after the owner has communicated expectations and provided direction and adequate training. However, when an employee continues to perform poorly after the owner-manager has done what can be done, discipline is imperative. Not disciplining an employee when appropriate causes performance problems, just as overdisciplining does.

1. Employees are informed when performance is below standard.

   Poor performance will not improve on its own. The first step is to inform the employee of poor performance. If this does not improve the situation, state the performance problem and what is expected in writing, so that the employee understands the seriousness of the situation. If this still doesn't work, and the employee is properly trained, immediate disciplinary action should be taken.

2. Unexcused absences are dealt with immediately.

   If employees see that unexcused absences are not punished, productivity will decline. The offender's performance will likely decline in other areas and the owner-manager's ability to discipline effectively will deteriorate.

3. Theft prevention measures are in place.

   Employee theft is often a serious problem. Different kinds of businesses need different measures in this area, but the owner should be aware of possible problems and have specific policies and procedures to deal with them. Employee theft hurts the performance of those who are not involved and also imperils profits.

D. Regular employee meetings are conducted.

Employee meetings are one of the most effective ways of communicating with employees and spotting areas where improvement in the operation can be made. Too many small business owners do not know how to conduct good meetings, so they don't even try. Those businesses that use employee meetings effectively are often very profitable and have fewer performance problems. If the owner does not know how to conduct an effective employee meeting, training in this area should be suggested.

1. Employees' ideas are solicited at meetings.

   Consultants are often hired to tell owners what their employees already know. This is a very costly way of finding out what is needed to improve the business. Simply asking employees what they think and how they would like to see performance improved will often generate many good ideas. However, it is essential that the owner actually uses some of these ideas, or employees will soon learn that the owner doesn't really want to improve the business.

2. An agenda is given to employees prior to the meeting.

   Giving the employees an agenda prior to the meeting lets them know what is expected of them at the meeting and demonstrates that the owner feels their input is important. It also cuts down on rumors and anxiety generated when employees don't know what is going on.

Exhibit E - Operations Audit Analysis

I. Production

A. Inventory

1. The company has a good relationship with suppliers.

   Your suppliers are critical to your business survival and prosperity. It is essential that you have a written and well-documented plan on how to deal with suppliers. This document should incorporate delivery schedules, quality of material and services provided, payment terms and any other particulars regarding the procurement of raw materials and services. It should also contain contingency plans in case there are unforeseen problems. This document should be provided to all major suppliers. In addition, make certain that you remain in personal contact with your suppliers.

2. The company provides for inventory control.

   The right amount of raw materials ensures the success of the production operation. Too much inventory at any given time can be as much a production impediment as too little. Inventory must be maintained at proper levels and provided in a timely fashion. Production efficiencies erode quickly when material is not available when needed. If owner-managers overcompensate by procuring large amounts of inventory, the probability of spoilage and damage to the inventory is quite high, not to mention the negative impact of having cash tied up unnecessarily.

3. The company conducts incoming inventory inspections.

   Another important document is an incoming quality assurance policy. This document should set out the firm's standards for the quality of incoming raw materials. A firm may pay a premium to the vendor for a specified quality level of incoming materials or may choose to employ a statistical sampling technique. It may also inspect all incoming materials, depending on the nature of the product being produced. In any event, the criteria used to inspect incoming inventory should be documented and well publicized to all parties involved. Poor quality raw materials not only lead to the production of inferior products, loss of customers and damage to the firm's reputation, but often also can cause damage to the production equipment and create frustration on the part of machine operators.

4. The company has alternate sources of raw materials.

   An organization or a firm may have a fantastic relationship with a very competent supplier, but it is essential that alternative sources of supply be identified. It is recommended that the majority of a firm's raw material requirements be equally divided between two major suppliers, with a third source receiving lesser, but consistent, amounts.

B. Equipment

1. The company has a routine maintenance program.

This is a must! What maintenance needs to be done and when it needs to be done should be documented and communicated to equipment maintenance people. Every major piece of equipment should have a maintenance log positioned in an obvious place where one can confirm that the routine maintenance schedule is being followed. When a firm is short of cash, frequently one of the first items cut is routine maintenance expenditures. However, the small savings that result from such cutbacks may later result in much larger expenditures to adequately maintain or rebuild the equipment.

2. Preventive maintenance is a regular occurrence.

   Like routine maintenance, the firm needs a well-written and -communicated policy on preventive maintenance. Unlike routine maintenance activities, which are normally accomplished duringoff production hours, at night and on weekends, with little interruption of production, preventive maintenance activities require a major amount of down time. The written policy should address a routine so that only one piece of major equipment is down for refurbishing at a time, thus minimizing lost production hours. Failure to do preventive maintenance may result in a critical machine's breaking down just when production requirements are highest.

3. The company has a written operator training program.

   All production supervisors, as well as new employees, should have a copy of the operator training manual. This manual should include a step-by-step narrative of how the job is to be performed. Training techniques that can be employed range from classroom instruction to apprenticeship programs in which new employees work alongside an accomplished operator. The manual should list learning rates, production tips and whom to contact with questions. Constructive feedback on training progress should be provided in a non-intimidating fashion to all new employees.

4. The company meets OSHA standards.

   Business owner-managers must obtain Occupational Safety and Health Administration (OSHA) standards that pertain to the business and incorporate them into a written document. Meetings with employees should be conducted regularly to ensure that all phases of the operation are in compliance with OSHA standards. Safety records and accidents requiring workers' compensation should be documented and maintained.

C. Processing

1. The company has an adequate scheduling process.

   Every production organization needs a well-thought-out scheduling process to enable grouped orders to proceed through production, maximizing efficiency and satisfying customer due dates. A scheduling chart allows instant recognition of where a particular job is in the production sequence. This chart also allows the firm to provide customers with information regarding the progress of their orders. Combining an effective scheduling process along with a current scheduling chart not only facilitates efficient production, but also allows for changes to meet production deadlines when complications arise.

2. In-process inventory is adequately controlled.

Where a production operation has several stages of activity, the movement and storage of in-process inventory becomes an item of major concern. Subassemblies that are produced in one manufacturing area must be available in sufficient quantities and in a timely fashion for the next stage of manufacturing. Quite often subassemblies are very fragile and subject to damage or contamination by foreign materials, thus it is important to ensure that their production and temporary storage is properly managed.

3. Finished stock is safely stored.

   It is important that finished stock be safely transported and stored in a clean and dry area. A firm may provide warehousing at its own location, or it may choose to store its finished product in a commercial warehouse. A firm may also choose to have stock warehoused by its customer. In any case, adequate care should be taken to protect the product from damage or theft. In the latter two cases, it is imperative that a written contract specify who is responsible for insuring the product. In addition to storage, it is critical that adequate controls be exercised to preclude excessive inventory buildups that could result in stock spoilage or obsolescence.

4. The company has an environmental awareness policy.

   With increasing emphasis being placed on environmental concerns, small businesses must now be aware of their responsibility for the environment. This is especially true in the disposal of hazardous waste materials. Appropriate information should be obtained through national and state environmental protection agencies and incorporated into a written policy for the business. In the case of environmental pollution the business will be held liable whether or not they understand their responsibilities. This is truly a case where ignorance of the law is no excuse. Sometimes, as energy is expended in deciding what to do with byproducts, new markets for such materials may be identified.

D. Technology

1. Company representatives attend trade shows.

   A key element to the survival and prosperity of any small business is its ability to use state-of-the-art technology; therefore, it is imperative that you stay abreast of advances in the technology related to your business. Attending trade shows on a regular basis is one method of staying current, even though this may be somewhat costly.

2. The company subscribes to trade publications.

   Trade publications are another source of information on technological advances. Many small businesses find this an inexpensive way to obtain information. Although the small business owner may have very little time for outside reading, taking the time to be informed about such matters is critical. Often this can be done during non-business hours.

3. A formal employee suggestion program is in place, and regular brainstorming sessions involving the employees are conducted.

   In addition to productivity enhancements that can be obtained from external sources, another vital source of productivity enhancement ideas is the employees who are actually engaged in the production activities. It is essential that the owner-manager establish a well-communicated employee suggestion program with immediate rewards. In addition, many fruitful ideas can be obtained from regular brainstorming sessions involving the employees.

4. The company is involved in the community's extended learning programs.

An often overlooked source of new production ideas and technological advances are the various extended learning programs in your community. The small business entrepreneur should become involved in such programs offered by community colleges, universities and technical training schools. These activities can range from taking classes to teaching classes. Not only does such involvement build good rapport with the community, it also is a valuable source of new ideas and technical innovations.

II. Sales and Marketing

A. The owner knows exactly what the business is.

Surprisingly, many owners don't know what business they are in. As stated earlier in the basic planning section, very few businesses are original, which is why it is essential to find an appropriate market niche. Small businesses must meet some unique need if they are going to be successful. Knowing what business you are in simplifies decision making; helps focus sales and marketing efforts; and communicates to customers, suppliers and loan officers that the business is a viable one.

1. The owner knows exactly who the customer is.

Who makes the buying decision? Often the true customer is not apparent. Valuable time is wasted talking to non-decision makers. Knowing who the customer is also helps with such facets of the business as product or service mix, advertising approaches and customer satisfaction.

2. Potential customers know about the business.

Continually identifying potential customers and educating them about the business is the hallmark of a prosperous operation. A quick survey of potential customers is adequate for determining if the business is known. If prospective consumers are not aware of the business, the owner should evaluate present promotional efforts and develop supplemental forms of advertising.

3. Location is appropriate for the business.

One of the major reasons for poor business performance in the SBI cases was poor business location and inadequate facilities. A given location may not be suited for all kinds of businesses. When the location is not appropriate, it may be necessary either to find a new one, to redefine the business or even to go into a new business entirely.

4. The market is clearly defined.

Having a clear understanding of the trade area and clientele can save both time and money. Ill-defined markets distort reality and lead to poor decision making in operations as well as sales.

B. The owner knows his or her competitors and their location.

That a business owner should know about the competition seems obvious, but small businesses often find it difficult to get this information. A quick check of the Yellow Pages will provide the location of the competition, and often a great deal can be learned about them through suppliers and sales representatives.

1. The owner knows how his or her prices compare with the competitions'.

Being price competitive is essential in most businesses; however, comparative pricing is not always a simple matter. To know if prices are truly competitive requires an awareness of quality, service and customer relations.

2. The owner knows how the competition is regarded.

A business's suppliers and customers can provide valuable information about that business's competition. If asked, these people are surprisingly eager to discuss the competition. The local Chamber of Commerce and Better Business Bureau can also provide valuable information.

3. Census data are used for strategic marketing.

This is the most overlooked source of marketing information. Demographic data can provide nearly unlimited information about general trends. Using these data for strategic marketing decisions can often provide competitive positioning. Being in the right place at the right time with the right product increases sales, reduces costs of sales and develops goodwill that adds to future sales.

4. The owner knows county sales patterns.

This information is probably most essential when deciding where to locate a business.

C. Owner and employees treat customers courteously.

Good customer relations are a highly subjective matter, but common courtesy seems to be essential to business success. Simple things like thanking the customer for doing business, being responsive to customer requests and providing requested information in a timely manner are some of the basics.

1. Customers' concerns, complaints and suggestions are listened to carefully.

In this fast-paced society, people don't take time to listen to each other. The business owner who listens to customers often finds repeat business and excellent suggestions on improving customer relations by better meeting the customers' needs.

2. Customers are provided with quick, reliable service. Americans like quick, reliable service. For most of the public you are likely to serve, quality and service are often more important

than price and can be your best form of advertising. Also, it is virtually impossible to beat the large conglomerates on a pure price basis; therefore, the small business has to provide a value added to its goods and services or it simply won't get customers.

3. The owner is considered knowledgeable by customers. Very often the reason people visit a small business is because they are buying knowledge as well as a product or service. This is just another reason why it is crucial to know what the customer wants.

4. Appropriate housekeeping procedures for the business are followed.

   Every type of business has standards of cleanliness. The small business must at least meet industrial standards. Often the small business that prides itself on cleanliness finds a unique market niche because it gets a reputation for cleanliness. This is especially true in the food and hospitality industries, but it can be just as important in garden and hardware stores.

D. The owner is aware of customer needs.

Too often, business owners are not in touch with customer needs. When sales are growing, it is generally a good sign that the business is meeting its customers' needs. Decreasing sales are a concrete sign that customer demands are not being met. The customer is always right; if one business does not provide what the customer seeks, he or she will go to a business that is more satisfying or accommodating.

1. Feedback is requested from customers.

   The only way to find out what customers need is to ask. There are many ways to ask; for example, marketing specialists can be retained. However, the simple question, How can I help you? will generally get the needed information. The courteous question sincerely asked is still the most effective way to find out what the customer needs and wants.

2. Sales receipts are monitored.

   An effective, unobtrusive way of identifying customer needs and preferences is to monitor sales receipts. It is relatively easy to discover customer preference by keeping a record of types of sales, brand names bought or requested, etc. Some businesses also keep a record of customer requests for unstocked items as a means of identifying new product lines.

3. Sales receipts are compared to those from previous years.

   Annual comparisons of sales receipts often can be used to anticipate emerging trends. Changes in volume, quantity, quality and seasonal shifts in sales can be anticipated, thus allowing for modifications in inventory levels, advertising and promotional planning. Comparing sales receipts can provide valuable planning information, which can increase savings and profits. The business's records are full of information that, if used, can make a difference in profitability.

4. Seasonal variations are taken into account.

Knowing turnover rates of inventory, stocking for seasonal variations and monitoring seasonal sales are integral to effective cash-flow management as well as for profit maximization.

E. The company needs to increase sales volume.

An increase in sales volume was required in all the SBI cases analyzed. Nothing happens until the sale is made. Sales volume is directly related to sales planning and execution. In some cases, the owner simply did not know how to sell, but this did not appear to be the major problem. Poor or inadequate planning seemed to be the major culprit.

1. There is a sales plan in effect.

Sales don't just happen -- they are planned. A good sales plan takes into account the fact that sales cost money. Advertising, promotion and personal selling all consume scarce resources. Personal selling is generally the most expensive, but for the businesses represented in the SBI study, effective personal selling was found to be an imperative.

2. Sales goals are being met.

Sales performance is basic. If sales goals are not being met, something is wrong. Either the goals are not realistic or faulty decisions are being made about what or to whom to sell. The annual budget is built on sales forecasts; if sales are being overprojected, spending must be reduced proportionately or the business will soon be in the red.

3. Effective sales presentations are being made to potential customers.

Many small businesspersons don't know how to make an effective sales presentation. If this is the case, sales training should be undertaken immediately. There are many workshops, seminars, tapes and books on how to conduct a sales presentation. The authors have found that customers will provide valuable feedback on selling techniques when asked. Practicing a sales presentation before a mirror or having a presentation videotaped can provide powerful instruction. Joining a group such as Toastmasters, serving on United Way campaigns or volunteering for community service committees also can teach the business owner how to make effective sales presentations.

4. Names of prospects are kept in a follow-up file.

Keeping a tickler or follow-up file on prospects is an indispensable selling tool. A simple file box with a calendar filing system and a stack of index cards is all that is needed for this. The entire system costs less than $6.

5. Sales are closed effectively.

Closing the sale is often the most difficult aspect of personal selling. It is a matter of timing and being attuned to the customer's body language. Overselling puts the customer off, even if the decision has already been made to buy. Trying to push for the sale too early turns off the cautious customer. Good selling is a matter of practice. Getting feedback from a professional salesperson is the most effective way of learning how to close effectively.

III. Advertising and Promotion

A. The owner has an advertising and promotion plan.

A major weakness in many of the SBI cases was lack of advertising and promotion planning. The owner-managers spent money randomly on advertising to promote particular items. A clear promotional objective with a well-developed plan of action helps to cultivate awareness of the business and creates a positive image. Random advertising may increase short-term sales, but it is not effective in developing market recognition for the business.

1. The business has an advertising budget.

Budgeting money for advertising encourages a consistent promotional effort and prevents cash flow problems caused by sporadic and unexpected advertising endeavors. Certain dependable advertising channels to be included in the budgeting process are the Yellow Pages, direct mail and flyers, newspaper and radio ads and business cards. The owner may have to budget personal time for the advertising process as well.

2. The business advertises on a weekly or monthly basis.

Potential customers need to see advertising regularly if it is to have a long-term impact. At a minimum, advertising should be scheduled on a monthly basis. Weekly advertising is even more effective, especially in businesses such as retail, variety and grocery stores. Whatever advertising approach is taken, continuous and consistent advertising communicates an image that the business has staying power and is reputable.

3. The business has a promotional calendar.

A well-developed annual promotional calendar helps multiply the impact of dollars spent on promotion and advertising. By comparing past promotional calendars with their corresponding source of funds statements, the effectiveness of past advertising campaigns can be ascertained. This simple procedure is a very effective means of increasing the impact of advertising on costs and potential profits.

B. The owner uses effective advertising and promotion.

The better the customers' needs are understood, the more convincingly a business can target its advertising toward those needs. Ineffective advertising is generally the result of not knowing the customers' habits and desires. Effective advertising, on the other hand, generally is not the result of blind luck, but the result of knowledge and understanding.

1. The owner advertises in the Yellow Pages.

An ad in the Yellow Pages lets customers know that the business is permanent. Many people, especially those new to an area, use the Yellow Pages for first-time buying. An ad in the Yellow Pages increases the odds of getting new business. In addition, it has the advantage of targeting the advertising at people who have made a decision to buy.

2. The owner uses newspapers and shoppers.

Many small businesses have found community shoppers and weekly newspapers to be cost-effective ways to advertise. This is especially true when those who read them also frequent the area near the business.

3. The owner uses radio and television advertising.

Radio and television are fairly expensive advertising media, but for some businesses, they are lucrative. The profitability of this form of advertising should be carefully analyzed before spending large sums of money.

4. The owner obtains no-cost or low-cost media coverage.

Every community has no- or low-cost advertising opportunities. Placing business cards on bulletin boards, speaking before various community groups, using special events to get publicity, or donating services to a newsworthy cause are all effective ways of advertising. Law firms have used politics for years as a low-cost way to become known to the general public. Pet stores have donated time or supplies to the Humane Society. Office supply stores provide supplies and surplus equipment to schools, churches and other goodwill organizations. Some creative thinking often can produce a higher payoff than traditional advertising approaches.

C. The owner uses effective merchandising techniques.

Attractive displays of merchandise are critical in retail operations. Simple but effective merchandising techniques might include displaying items near the cash register, putting high turnover items at the back of the store to draw customers through the store and placing quality items at eye level. Franchise operations often do an excellent job of using merchandising techniques. Initiating well-known franchise business methods can be an excellent way to learn new merchandising techniques.

1. The owner relates display space to sales potential.

Keeping shelves stocked with a balanced inventory ensures that customers can find what they want when they want it. Having top-quality items at eye level and lower-quality items below is a technique chain stores use to encourage customers to buy more expensive items. Older inventory should be displayed prominently and its turnover monitored daily. This can also help the owner discover the hot selling spot, which can be advantageous in planning future displays.

2. The owner uses vendor promotional aids.

Vendors put a great deal of time and money into their display packages. Using the vendor's displays and using vendor-prepared promotional ads with those displays can be an effective way of leveraging advertising and promotional dollars.

3. The owner understands traffic flow patterns of customers.

How customers move past displays and through the store can be used to increase sales. For example, most people turn to the right upon entering a building -- seeing how the tile or rug wears is one way of determining customer flow patterns.

4. The owner keeps facilities clean.

   Making certain that the store and its merchandise are clean communicates to customers that the owner cares about them. It is an effective nonverbal way of telling customers that their business is appreciated.

D. The owner evaluates advertising and promotional efforts.

If it works, don't fix it and if it doesn't, change it. Because advertising uses valuable resources, the small businessperson must closely monitor the effectiveness of advertising and promotional efforts. The only way to test advertising ideas is to try them. However, what works one time won't necessarily work again. In addition, what works for one store may not work for another. Advertising and promotion are more art forms than sciences. Too often, small businesses either advertise ineffectively or too little. Analyzing the results of sales efforts and promotional campaigns and how leads are generated facilitates the use of advertising dollars in a more effective manner.

1. The owner determines if sales increase with advertising.

   If sales don't increase with advertising, it may be a sign that the business owner doesn't know or understand who the customer is and why he or she buys.

2. The owner ascertains if sales increase after special promotions.

   If a special promotion doesn't increase sales, then the business may be in a poor location or there may not be enough potential customers in the business area. If special promotions don't increase business, the owner must take a hard look at the business. Perhaps there just isn't a market for goods or services offered by the firm.

3. The owner endeavors to discover if advertising is reaching intended markets.

   Many small businesses become contented when advertising increases sales. However, additional sales that do not increase profits need reevaluating. Reaching a market other than the intended one is probably a stroke of luck rather than an act of planning. It's great the one time it happens, but it cannot be relied upon. One-time (variety methods) advertising has its advantages, but it is the type of advertising that most small businesses cannot afford.

Exhibit F - Financial Audit Analysis

I. General Bookkeeping and Accounting Practices

A. The company has a single- or double-entry bookkeeping system.

Record keeping is vital to the survival and success of any business. According to analysis of the SBI cases, problems with record keeping constituted the second-largest problem area. Whether the business used a single- or double-entry system did not appear to be as important as how the system was executed. Timely and accurate record keeping is essential.

1. The owner prepares the books.

The small business owner who understands bookkeeping, records the transactions and prepares the financial statements has an intimate knowledge of the business. Knowledge of these accounting and financial aspects makes the owner credible with lending institutions. It also keeps the owner out of financial trouble and helps him or her stay focused on ways to make a profit.

2. The owner pays for bookkeeping service.

The owner who does not understand the essentials of bookkeeping needs to hire a trusted professional. Even then, the owner needs to understand financial statements. Failure to understand essential financial statements is an indication that the owner has surrendered managerial responsibility. It is generally wise to have the professional bookkeeping service prepare taxes when the service is already keeping the books. The owner who does not do the record keeping is rarely in close enough touch with the records to adequately prepare tax forms. The business owner who delegates so much financial responsibility to others should think seriously about using a CPA.

B. The owner reconciles bank statements monthly.

A quick way to get into financial trouble is not to reconcile bank statements monthly. With a single-entry bookkeeping system, this is the only way to maintain accuracy. Even when a double-entry system is used, reconciling statements monthly is the only sure way to catch mistakes. Too many small business owners put this off because of other, more pressing, concerns. This destroys the validity of their own financial statements, causing them to make important decisions based on erroneous data.

C. The owner keeps income and expense statements accurate and prepares statements monthly.

The ability to track the flow of funds into and out of the business is necessary for continued viability. Cash flow problems have closed many small businesses. The monthly preparation of accurate income and expense statements is the best single way to avert critical cash shortages.

1. The owner understands purpose of financial statements.

An owner who understands that financial statements are essential for directing and controlling a business will more likely take them seriously. Well-prepared business statements put the owner in control of the business, facilitate relationships with lending institutions and simplify tax preparation, often saving the owner tax dollars.

2. The owner compares several monthly statements for trends.

   Comparing monthly and annual statements for trends provides financial data for planning purposes. Trend analysis is essential for efficient inventory control, capital budgeting, vacation scheduling, timely advertising, promotional campaigns and profit maximization.

3. The owner compares statements against industrial averages.

   Knowing how a business compares financially to others helps the owner who is seeking loans or expansion opportunities. Such knowledge also provides the owner with both a psychological and planning advantage, adds to the owner's awareness of how well the industry is doing as a whole and provides an early warning system for market fluctuations and trends.

4. The owner knows current financial status of business.

   Not knowing how the business is doing financially is a major reason for small business failures. Managing the business with relatively simple financial tools and staying constantly in touch with the business's financial status is critical if an adequate profit is to be made. Although good record keeping is time consuming and takes away from doing the actual work of the business, it is essential nevertheless if the business is to be a success.

D. The company makes monthly deposits for federal withholding and Social Security taxes.

Government regulation makes this mandatory; there are penalties for not reporting accurately and in a timely fashion. Another important reason for timely deposits is employee morale. Not filing the proper forms can create problems for employees, resulting in disgruntled employees. This in turn can harm customer satisfaction and loyalty, eventually destroying profits and sometimes threatening the business's survival.

1. The owner understands Form 941.

   Form 941 is used to report quarterly the income tax and Social Security that the business withholds from the employee's wages, and the matching Social Security contribution paid by the employer. Not doing this as required by law is costly in terms of penalties and interest assessed by the government.

2. The owner makes deposits on time to avoid penalties.

   Penalties are costly and take away from profits. In several of the SBI cases, late deposits had become so chronic, and the penalties so high, that the businesses were financially threatened. Chronic penalties for late deposits are a sure sign of poor business practices and can be a warning sign to lending institutions that the business is heading for financial trouble, making it highly unlikely the owner will be able to get a loan when needed.

3. The owner provides W-2 information.

Not providing correct W-2 information is a sure way to get into trouble with the Internal Revenue Service. Providing the correct information takes little time and prevents costly delays later. Not paying attention to such government details is often an indication that other business details are also being ignored. Such sloppy management practices warn bankers and other lenders that the owner is a poor credit risk.

E. The company has a credit policy.

Providing credit to customers can often increase sales volume. But if the business does not have a written credit policy or does not follow it exactly, the business may lose more money on bad debts than the additional sales brought in. Written credit policies often speed debt collections, especially when discounts can be made for early payments. Several of the SBI cases showed a marked improvement in cash flow after credit policies were implemented.

1. The company ages the billing system monthly.

   Monthly aging of the bills due keeps the owner in touch with who the best customers are. Last year's excellent customer can be today's problem customer.

2. The company assesses a late payment fee from customers.

   Late payments can jeopardize the business-customer relationship, because the customer is not aware of how poor payment habits affect the business. Providing discounts for early payments is an effective way to encourage customers to pay on time. This will improve cash flow and even build customer loyalty.

3. The company writes off bad debts.

   Not writing off bad debts gives a false sense of net worth and can threaten the financial performance of the business. This also lets the owner know which customers are poor credit risks.

4. The company has good collection policies.

   Many small business owners detest debt collections. A good collection policy simplifies collections and is an effective deterrent to late payments and bad debts. Timely and effective debt collection is essential for positive cash flow and increases profits because it diminishes the need for short-term operating loans.

5. The company has a series of increasingly pointed letters to collect from late customers.

   The customer who is truly a collection problem will not be influenced by discounts or good collection policies alone. These customers probably have cash flow problems or other financial problems of their own. Late notices and overdue statements with increasingly demanding language will be required. Often letters from a lawyer can be helpful. As a last resort, it may be wise to turn them over to a collection agency.

6. The company has VISA, MasterCard or other credit card systems.

Credit card systems provide timely cash turnaround and put the financing burden directly on the customer. The worry and headaches alleviated by using a credit card system more than justify the small fee credit card companies charge. Such a system also simplifies bookkeeping and billing and lowers operating costs in these areas.

7. The company emphasizes cash discounts.

Cash discounts encourage customers to pay now rather than use credit. Informing customers that paying by cash saves them money improves cash flow and decreases collection costs.

F. The company files all tax returns in a timely manner.

Not filing tax returns in a timely manner is a sign of poor organization. Procrastination has been the downfall of many small business owners. No one enjoys filing tax returns, but putting off the inevitable until later doesn't make it any easier. Getting the tax forms in on time is also a good general business practice, because it may be the only time during the year when an accurate picture of business performance can be obtained.

1. The owner considers tax implications of equipment.

Waiting until the last minute to consider the tax implications for the purchase of equipment and other capital outlays can be costly. Thinking ahead and discussing tax implications of various alternatives with an accountant early in the year can save in taxes. Tax considerations are essential for all businesses, but for the small business, such considerations can make the difference between a profit and a loss.

2. The owner considers buy versus lease possibilities.

Deciding whether to buy or lease equipment is an important business consideration. Leasing rather than borrowing money to buy can help cash flow, save taxes and increase total operating capital. One reason to consider leasing equipment is that it may save downtime when equipment needs repairs.

3. The owner considers possible advantages and disadvantages of incorporation/Subchapter S.

Each kind of business structure has its own advantages. Most of the businesses in the SBI cases studied were either sole proprietorships or Subchapter S corporations. In essence, the S-corporation is not affected by corporate income tax, because it is treated as a partnership. Other than this, the S-corporation and the standard corporation share most of the same advantages and disadvantages.

4. The owner does not pay tax penalties (federal, state, local).

It should be obvious that any business paying tax penalties is losing profits. Worse than this, not paying taxes on time creates many time-consuming headaches. It also sends a message to lenders that the business is a poor risk.

II. Financial Planning and Loan Proposals

A. The company has adequate cash flow.

Inflation and fluctuating interest rates have made it mandatory for small businesses to closely manage their cash flow. Given the added problem that many small businesses owe money, it is little wonder that an adequate cash flow is essential to the firm's health and financial stability. Businesses that are otherwise healthy can become insolvent simply because of poor cash flow.

1. Prenumbered cash receipts are monitored and accounted for.

   The use of prenumbered receipts is the simplest way to keep track of customers and sales. It is also the source document for building the accounting system. Another reason for using prenumbered receipts is that they can reduce inventory shrinkage and reduce the time spent on physical inventory audits.

2. Checks are deposited properly each day.

   A basic principle of cash management is to keep it moving. The faster cash moves from the customer to the bank and into appropriate short-term investments, the better. Another benefit of daily check deposits is that they decrease the possibility of loss, which creates numerous other problems.

3. Customer invoicing is done promptly (within two working days).

   Waiting to bill customers is a poor practice. It communicates to customers that it is okay to be late with their payments. Incorrect invoicing also creates delays and takes valuable time to correct.

4. Collections are received within 60 days.

   When it takes longer than 60 days to collect payments, the business needs to examine its credit and collection policies. Long collection periods increase operating expenditures through additional billing costs, lost interest and the need to borrow to meet current operations.

5. Accounts payable take advantage of cash discounts.

   Taking advantage of cash discounts that suppliers offer saves money and is an important step for the business in its attempts to establish itself as a primary customer. Being considered such a customer can facilitate delivery, improve services and can be an excellent source of new business leads.

6. Disbursements are made by prenumbered check.

   Prenumbered checks are primary source documents for accurately determining expenses. Not using them increases the time spent on bookkeeping, makes it difficult to monitor expenses accurately, increases the probability of double payments and communicates to suppliers that the business is a marginal operation.

B. The company projects cash flow needs.

Most small businesses use a cash basis rather than an accrual basis of accounting. Though a cash basis is easier and takes less time to maintain, it often gets the business into trouble, because the business has incurred expenses for which there is no proper accounting. By keeping track of accounts receivable and accounts payable, it is relatively easy to project cash flow needs.

1. Payrolls are met without problems.

   When a business has a problem meeting its payroll, drastic action is generally needed to save it from financial ruin. Generally, the owner-manager has not been watching the books closely enough. When this happens, it is a sure sign that general business practices are poor. On the other hand, an ability to meet the payroll is usually a sign that the business is at least in a fair state.

2. Money is set aside for expansion, emergencies and opportune purchases.

   Few small businesses have the advantage of being cash rich. Many fail simply because they do not have money set aside for emergencies -- they operate too close to the margin. Having an emergency fund should be considered a necessity rather than a luxury. Having an expansion fund, or a special fund set aside to take advantage of opportunities, not only reduces stress for the owner, but can often provide an operational advantage for the business.

3. Short-term financing is used when needed.

   A small business should borrow money only when needed or when analysis proves it will be profitable to do so. Short-term financing is essential to a seasonal business. But poor analysis turns short-term loans into long-term debt, putting the business in a precarious financial position. Incorrect use of short-term financing was a major problem for a number of the SBI cases studied.

4. A line of credit is established with a bank.

   Having a predetermined line of credit means the business is a good credit risk. It is a sign that the business is well managed. A preestablished credit line provides operational flexibility and, when used properly, can provide a source of funds to meet emergencies or to take advantage of investment opportunities. Another advantage of developing a line of credit is that it establishes a relationship between the business and the bank, facilitating later acquisition of long-term financing for expansion, etc.

C. The company understands the role of financial planning in today's highly competitive lending markets.

In order to obtain credit in today's tight money markets, financial planning is essential. Lenders want to know as much about the person to whom they are lending as they do about the business. This means that a well-prepared business plan as well as a detailed personal statement will be required.

1. The owner's personal resume is prepared and current.

   A well-written and professionally prepared resume is an indispensable document for obtaining small business loans in today's market. Obtaining a small business loan takes personal salesmanship, and the owner must demonstrate competence to run the business. A well-prepared resume informs the loan officials that the owner is qualified to manage the business and repay the loan on schedule.

2. Personal financial statements have been prepared.

   Even when the business is incorporated, most lending institutions assume they are lending money to the owner personally. Having a well-prepared personal financial statement can increase the probability of obtaining a loan.

3. There is a written business plan.

   A written business plan is a road map that tells a loan officer what the business is, where it is going and how it is going to get there. Without a well-developed business plan, it is unlikely that a loan will be obtained.

4. There is a source and use of funds statement for the past two years, with a projection for the next two years.

   The source and use of funds statement, more than any other document, lets the loan officer know if the business is viable. It is also essential for the management of cash flow and is an essential operating document, even when a loan is not being requested.

5. There is an accurate balance sheet for the past two years, with a projection for the next two years.

   Historically, the balance sheet has been the primary financial document used by loan officers and others in the financial community to determine the financial health of a business. It is still necessary to include balance sheets in the loan proposal package, though, by themselves, they are no longer sufficient documentation for obtaining loans.

6. The owner has a good working relationship with the banker.

   The small businessperson must have a good professional relationship with the banker and must keep the banker informed about the business on a quarterly basis. A well-informed banker can provide valuable financial information and will be more likely to lend money when it is requested.

7. There is a strong debt-to-equity ratio (1:2/1:1).

   It should be obvious that a banker only wants to lend money to a successful business. The banker also wants to know that the owner has at least as much at stake as the bank, and preferably twice as much.