

# How are we doing?

An Effectiveness Checklist for the Growing Business

*Expert knowledge means success*

## **Contents**

- 1. Introduction
- 1. What the Effectiveness Checklist can do and what it can't do
- 1. Honest is the best policy
- 7. Management Audit Analysis
- 11. Operations Audit Analysis
- 18. Financial Audit Analysis
- 22. Further Information

**Note:** This publication has not been updated since it was last published. Some of the hyperlinks may have changed and may need updating. In addition, some of the information in this publication may be out of date.

## Introduction

Small businesses fail more often than not because their owners aren't aware of the many elements that can prevent their business from growing and being successful. Often, small businesses are organized around the owner/manager's specific area of expertise, such as marketing, accounting or production. This specialised expertise can often be a disadvantage rather than an advantage because it prevents the business owner from recognising problems that may arise in other parts of the business.

This publication is designed to help the small business owner. It provides the small business entrepreneur with the essentials for conducting a comprehensive search for existing or potential problems. The checklist was designed with small businesses in mind and addresses their unique problems and opportunities.

## What the Effectiveness Checklist can do and what it can't do

Analysis in the US (and there's no reason to believe that the UK would be any different) showed that small businesses have used consultants to help them obtain essential information for conducting many of their business affairs - such as basic planning, general business practice, accounting, finance and loan procurement, advertising and promotion, market research, feasibility studies and operations.

Checklists and comparisons against good practice are useful tools for managers to measure effectiveness.

Although our approach to measuring effectiveness is a useful tool, the business owner/manager still must rely on personal judgement and past experience. Our Checklist does provide a systematic framework to ensure that critical areas have been addressed before action is taken. In a way, the approach is an "audit" and must not

be thought of as anything other than a useful management tool - it's not a replacement for good management skill. Used properly, the Checklist can save valuable time for the seasoned as well as the novice small business manager.



## Audit Checklist for the Growing Business

The Checklist is designed under these sections:

### 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

## Honesty is the best policy

Honesty (or rather frankness) really is the best policy - in order to gain maximum effectiveness from this audit, the small business manager should answer all questions in the Checklist, with an affirmative answer indicating no problem and a negative answer indicating the presence of a problem in a specific area.

After completing the Checklist, the manager can review the results to determine what action is most appropriate. The analysis provides an overview of how the various elements of the in-depth examination of the business are related with emphasis on seven critical business functions:

- Basic planning;
- General bookkeeping and accounting practices;
- Financial planning and loan proposals;
- Sales and marketing;
- Advertising and promotion;
- Personnel;
- Production.

# Checklist for the Growing Business

The Checklist is designed to analyse a business under three major audits:

- The management audit;
- The operations audit;
- The financial audit.

In the healthy and financially sound small business, the seven functional areas mentioned above are likely to be 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.

THE MANAGEMENT AUDIT		
I Basic Planning	Yes	No
<b>A. The company has a clearly defined mission.</b> 1. There is a written mission statement. 2. The Company is carrying out the mission. 3. Mission statement is modified when necessary. 4. Employees understand and share in the mission.		
<b>B. The company has a written sales plan.</b> 1. Market niche has been identified. 2. New product lines are developed when appropriate. 3. Targeted customers are being reached. 4. Sales are increasing.		
<b>C. The company has an annual budget.</b> 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. The Owner prepares the budget. 6. The budget is realistic.		
<b>D. The company has a pricing policy.</b> 1. Products or services are competitively priced. 2. Business provides volume discounts. 3. Prices are increased when necessary. 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	Yes	No
<b>A. Employees know what is expected of them.</b> 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>B. Each employee has a job description.</b> 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.		
<b>C. Preventive discipline is used when appropriate.</b> 1. Employees are told when performance is below standard. 2. Unexcused absences are dealt with immediately. 3. Theft prevention measures are in place.		
<b>D. Regular employee meetings are conducted.</b> 1. Employees' ideas are solicited at meetings. 2. An agenda is given to employees prior to the meeting.		

# Checklist for the Growing Business

THE OPERATIONS AUDIT		
I Production	Yes	No
<b>A. The company has a good relationship with suppliers.</b> 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>B. The company provides for good inventory control.</b> 1. The Company has an inventory control formula to provide for optimum inventory levels. 2. The Company has a policy on securing inventory in a timely fashion.		
<b>C. The company conducts incoming inventory inspections.</b> 1. Company has a written policy on incoming inspection. 2. Incoming inspection is being performed. 3. Incoming inspection levels of quality are documented.		
<b>D. The company has alternate sources of raw materials-</b> 1. Two or more suppliers are identified for each product that is needed. 2. The majority of raw material requirements are divided equally between two major suppliers with a third source receiving lesser but consistent orders.		
<b>E. The company has a routine maintenance programme.</b> 1. A routine maintenance programme is documented and communicated to all maintenance personnel. 2. Every major piece of equipment has a maintenance log that is positioned in an obvious place. 3. Preventive maintenance is a regular occurrence.		
<b>F. The company has a formal operator-training programme.-</b> 1. The Company has a written operator-training manual. 2. A progressive training process is in place. 3. Experienced operators are identified to answer questions from trainees. 4. Constructive feedback on training progress is provided in a non-intimidating fashion.		
<b>G. The company meets Health &amp; Safety (H&amp;S) standards.</b> 1. Company is aware of H&S standards that relate to the business. 2. Company conducts regular meetings with employees about H&S standards. 3. All safety records and accidents are documented.		
<b>H. There is a well-documented processing procedure.</b> 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/dry area. 5. Adequate controls are provided to preclude excessive stock build-ups that could result in finished stock spoilage or obsolescence.		
<b>I. The company has an environmental awareness policy.</b> 1. A policy dealing with the proper disposal of hazardous waste materials is fully documented and communicated to all pertinent parties. 2. Attempts are made to stay up-to-date with all existing environmental regulations. 3. Regular meetings are conducted to determine better methods of dealing with by-products.		

# Checklist for the Growing Business

THE OPERATIONS AUDIT		
I Production	Yes	No
<p><b>J. The company attempts to stay up-to-date with technological advances.</b></p> <ol style="list-style-type: none"> <li>1. Company representatives regularly attend trade shows.</li> <li>2. The Company subscribes to trade publications.</li> <li>3. A formal employee suggestion programme is in place.</li> <li>4. The Company conducts regular technology advancement brainstorming sessions involving the employees.</li> <li>5. The Company is involved in extended adult learning programmes in the local community.</li> </ol>		

THE OPERATIONS AUDIT		
II Sales and Marketing	Yes	No
<p><b>A. The owner knows exactly what the business is.</b></p> <ol style="list-style-type: none"> <li>1. The owner knows exactly who the customer is.</li> <li>2. Potential customers know about the business.</li> <li>3. Location is appropriate for the business.</li> <li>4. The market is clearly defined.</li> </ol>		
<p><b>B. The owner knows competitors and their location.</b></p> <ol style="list-style-type: none"> <li>1. The owner knows how prices compare with that of the competition.</li> <li>2. The owner knows how the competition is regarded.</li> <li>3. Reliable data is used for strategic marketing.</li> <li>4. The owner knows the regional and local sales patterns.</li> </ol>		
<p><b>C. The owner and employees focus on customer needs.</b></p> <ol style="list-style-type: none"> <li>1. The owner and employees treat customers courteously.</li> <li>2. The customer's concerns, complaints and suggestions are listened to carefully.</li> <li>3. Customers are provided with quick, reliable service.</li> <li>4. Customers consider the owner knowledgeable.</li> <li>5. Appropriate housekeeping procedures for the business are followed.</li> </ol>		
<p><b>D. The owner is aware of customer needs.</b></p> <ol style="list-style-type: none"> <li>1. Feedback is requested from customers.</li> <li>2. Sales receipts are monitored.</li> <li>3. Sales receipts are compared to previous years.</li> <li>4. Seasonal variations are taken into account.</li> </ol>		
<p><b>E. The company needs to increase sales volume.</b></p> <ol style="list-style-type: none"> <li>1. There is a sales plan in place.</li> <li>2. Sales goals are being met.</li> <li>3. Effective sales presentations are being made to potential customers.</li> <li>4. Names of prospects are kept in a follow-up file.</li> <li>5. Sales are closed effectively.</li> </ol>		
III Advertising and Promotion	Yes	No
<p><b>A. The owner has an advertising and promotion plan.</b></p> <p>The business:</p> <ol style="list-style-type: none"> <li>1. Has an advertising budget.</li> <li>2. Advertises monthly.</li> <li>3. Advertises weekly.</li> <li>4. Has a promotional calendar.</li> </ol>		
<p><b>B. The owner uses effective advertising and promotion.</b></p> <p>The owner:</p> <ol style="list-style-type: none"> <li>1. Advertises in directories</li> <li>2. Uses newspapers and "shoppers".</li> <li>3. Uses radio and television advertising.</li> <li>4. Obtains no-cost or low-cost media coverage.</li> <li>5. Uses up-to-date, flexible literature</li> </ol>		
<p><b>C. The owner uses effective merchandising techniques.</b></p> <p>The owner:</p> <ol style="list-style-type: none"> <li>1. Relates display space to sales potential.</li> <li>2. Uses vendor promotional aids.</li> <li>3. Knows traffic flow patterns of customers.</li> <li>4. Keeps the facilities clean.</li> </ol>		

# Checklist for the Growing Business

THE OPERATIONS AUDIT		
III Advertising and Promotion	Yes	No
<p><b>D. The owner evaluates advertising and promotional efforts.</b> The owner:</p> <ol style="list-style-type: none"> <li>Determines if sales increase with advertising.</li> <li>Ascertain if sales increase after special promotion.</li> <li>Finds out whether advertising is reaching the intended market.</li> </ol>		

THE FINANCIAL AUDIT		
I General Bookkeeping and Accounting Practices	Yes	No
<p><b>A. The business has a bookkeeping system.</b> a. Is it single entry? b. Is it double entry? c. Is it computerised/</p>		
<p><b>B. The owner:</b></p> <ol style="list-style-type: none"> <li>Prepares the books.               <ol style="list-style-type: none"> <li>Understands the how and why.</li> <li>Prepares own financial statements.</li> </ol> </li> <li>Pays for bookkeeping service.               <ol style="list-style-type: none"> <li>Understands financial statements.</li> <li>Has taxes done by bookkeeper.</li> <li>Has compared cost of a bookkeeper with that of outsourcing to a professional firm of accountants.</li> </ol> </li> <li>The company reconciles bank statements monthly.</li> <li>The company keeps income and expense statements accurately and prepares statements monthly.</li> </ol>		
<p><b>C. The owner:</b></p> <ol style="list-style-type: none"> <li>Understands purpose of financial statements.</li> <li>Compares several monthly statements for trends.</li> <li>Compares statements against industry averages.</li> <li>Knows current financial status of business.</li> </ol>		
<p><b>D. The company makes monthly savings/payments towards PAYE and NI and VAT and other taxes.</b> The owner</p> <ol style="list-style-type: none"> <li>Pays PAYE and NIC on a monthly basis.</li> <li>Properly accounts for Class 1A NIC on time.</li> <li>Properly records details of and files P11Ds for all directors and for all employees earning (with expense reimbursement) over £8,500 a year.</li> <li>Completes VAT Returns on time.</li> </ol>		
<p><b>E. The company has a credit control policy.</b> The company</p> <ol style="list-style-type: none"> <li>Ages billing system monthly.</li> <li>Charges interest or late payment fee to customers.</li> <li>Writes off bad debts.</li> <li>Has a good collection policy.</li> <li>Has a series of increasingly pointed letters to collect from late customers.</li> <li>Has VISA, MasterCard, or other credit card system.</li> <li>Emphasises cash discounts.</li> </ol>		
<p><b>F. The company files all tax returns on time.</b> The owner</p> <ol style="list-style-type: none"> <li>Considers tax implications of equipment early.</li> <li>Considers buy versus lease possibilities.</li> <li>Considers possible advantages/disadvantages of incorporation.</li> <li>Does not pay tax or VAT penalties</li> </ol>		

# Checklist for the Growing Business

THE FINANCIAL AUDIT		
II Financial Planning and Loan Proposals	Yes	No
<p><b>A. The company has adequate cash flow.</b></p> <ol style="list-style-type: none"> <li>1. Pre-numbered cash receipts are monitored and accounted for.</li> <li>2. Monies received are deposited at the bank daily.</li> <li>3. Customer invoicing is done promptly (within 2 days).</li> <li>4. Collections are received within 60 days.</li> <li>5. Accounts payable take advantage of cash discounts.</li> <li>6. Disbursements are properly documented and controlled.</li> </ol>		
<p><b>B. The company budgets its cashflow needs.</b></p> <ol style="list-style-type: none"> <li>1. Payrolls are met without problems.</li> <li>2. Money is set aside for expansion, emergencies and opportune purchases.</li> <li>3. Short-term financing is used when needed.</li> <li>4. A proper line of credit is established with a bank.</li> </ol>		
<p><b>C. The company understands the role of financial planning in today's highly competitive lending markets.</b></p> <ol style="list-style-type: none"> <li>1. The owner's personal resume is prepared and current.</li> <li>2. Personal financial statements have been prepared.</li> <li>3. The business has a written business plan.</li> <li>4. Source and use of funds statements exist for the past two years, with a projection for the next two years.</li> <li>5. An accurate balance sheet exists for the past two years and includes a projection for the next two years.</li> <li>6. The owner has a good working relationship with a banker.</li> <li>7. There is a strong debt-to-equity ratio.</li> </ol>		



## Management Audit Analysis

### I. Basic Planning

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

"What business are we in?" is a key question for many business owners to think about. 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 doesn't need to 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

##### 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's 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 a certain item of 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 realised. 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 isn't 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 research carried out shows that few owner-managers know who they are competing against. For example, a small hardware store may not be competing with the large shops like Robert Dyas 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. 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 many organisations, major problems occur when employees don't know who their boss is - worse still, many bosses don't know the proper reporting lines. A simple organisational chart can quickly solve this problem. It is important that every employee has 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.**

Sadly too many employees do not have adequate training to do their jobs. The causes for this are numerous, but one major cause ironically often has to do with a too-rapid growth of the business. Another major problem is poor recruitment.

### *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. Only effective planning and communication can solve this problem.

#### **3. Workload is distributed equitably.**

The perception of inequitable workloads destroys morale and productivity. Good planning, clear job descriptions and effective communication will go along 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 over-disciplining 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 rumours and anxiety generated when employees don't know what is going on.

## 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 programme.**

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 expenditure. 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 during off 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 H&S standards.**

Business owner-managers must obtain Health and Safety (H&S) standards that relate 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 H&S 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 specifies who is responsible for insuring the product. In addition to storage, it is critical that adequate controls be exercised to preclude excessive inventory build-ups 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 by-products, 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. It's 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 programme 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 programmes.**

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 is often 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 that of the competition.**

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 Enterprise Agency or Business Link 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 sales patterns by geographical area.**

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.**

Customers 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's 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 - check with us for the latest methods including the remarkable CAB (Customer Advisory Board). Often, the simple question, "How can I help you?" will generally get the needed information. The courteous question sincerely asked is still one of the most effective ways 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 un-stocked 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 your stock 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 is often top of the agenda for most small businesses. Nothing happens until the sale is made. Sales volume is directly related to sales planning and execution. In some cases, owners simply

don't know how to sell. 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 over-projected, 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 business owners 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. Often, 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.

## **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 £5.

## **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.*

Often, a major small business management weakness is lack of advertising and promotion planning. Many 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 endeavours. 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 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 ££s 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. In effective 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 analysed 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 Societies or Organisations caring for animals. Office supply stores provide supplies and surplus equipment to schools, churches and other goodwill organisations. 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 ££s.

## **3. The owner understands traffic flow patterns of customers.**

How customers move past displays and through a shop 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. Analysing 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 endeavours 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 re-evaluating. 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.

## 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. Problems with record keeping feature high on the list of problem areas for many small businesses. 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 Chartered Accountant

#### B. *The owner reconciles bank statements monthly.*

A quick way to get into financial trouble is not to reconcile bank statements on a monthly basis. 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 the 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 banks and other lending institutions as well as simplifying and saving tax.

##### 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 stock control, capital budgeting, vacation scheduling, timely advertising, promotional campaigns and profit maximisation.

##### 3. **The owner compares statements against industrial averages.**

Knowing how a business compares financially to others helps the owner who's 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 proper provision for its taxes and files returns to the authorities on time.*

Regulations make this mandatory; there are penalties for not reporting accurately and in a timely fashion.

Check with us for details about establishing tax strategies that work and compliance systems that ensure filings are made on time.

*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 businesses will show a marked improvement in cash flow after credit policies are 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 filed 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 the 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 money 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 the possibilities of buying versus leasing of assets.**

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.**

Each kind of business structure has its own advantages. Many small businesses are either sole proprietorships or partnerships. Only companies are affected by corporation tax but that may be an advantage as the rate of tax for a small company can be half that of a company - but a company does have many more rules and procedures to observe.

## **II Financial Planning and Loan Proposals**

### ***A. The business 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 cashflow is essential to the firm's health and financial stability. Businesses that are otherwise healthy can become insolvent simply because of poor cashflow

#### **1. Pre-numbered cash receipts are monitored and accounted for.**

The use of pre-numbered 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 pre-numbered receipts is that they can reduce inventory shrinkage and reduce the time spent on physical inventory audits.

#### **2. Cheques are deposited at the bank 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 cheque 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 pre-numbered cheque.**

Pre-numbered cheques 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 cashflow 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 pre-established 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 CV 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.**

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.

## Further Information

This guide is for general interest - it is always essential to take advice on specific issues.

We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

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