



Mary Hanson



## About the Business Advisor

The Business Advisor is written and published by Mary Hanson, a business attorney in Torrance, California.

Mary Hanson has a law degree from the University of Wisconsin and an MBA from the University of Southern California. She has practiced business law exclusively for 29 years.

She provides legal services related to owning, operating, buying, selling, and structuring businesses. Her clients are business owners in many different industries. She handles corporations, LLCs, new businesses, new ventures, and a broad range of contracts and business decision-making.

Her interests include flying and World War II.

Her law office is located in the Del Amo Financial Center, 21515 Hawthorne Blvd. #885, Torrance, California. She can be reached at (310) 543-1355 or by e-mail at [mhanson@bizadvisor.com](mailto:mhanson@bizadvisor.com)

## THE IMPORTANCE OF FINANCIAL MANAGEMENT IN DIFFICULT TIMES

by Mary Hanson

**W**hen times are tough or just threatening to get tough, one of the important things to do is to improve your financial management of your business.

You may need to:

- Speed up the availability of your financial information;
- Improve the accuracy of your financial information;
- Learn to prepare financial projections based on your most current financial information and your most current assessments of your industry and customer outlook;
- Utilize your financial information to meet important planning objectives.

Some financial objectives include:

- Knowing what your fixed overhead is.
- Knowing what your required break-even income is, covering both fixed overhead and all other expenses.
- Knowing what product lines, projects or services have the highest profit margins.
- Knowing what product lines, projects or services have the lowest profit margins.
- Knowing how much profit you need in order to meet objectives (other than breaking even and surviving).

- Determining where expenses can be cut.
- Determining where there is waste or inefficiency in your business.

In tough times, business owners often find it necessary to personally take charge of financial information. Learning to use the information as directly as possible, without waiting for work by a bookkeeper or accountant can be important. By personally reviewing the financial information for your business you may be able to improve the timeliness and the accuracy of the information and projections. Don't assume that anyone else working for you, whether an outside bookkeeper or an employee, knows your financial information or your business as well as you do. You are in a position to understand projections, profit margins, risks of non-payment, accuracy of estimates, and the likelihood of omissions better than anyone else.

If your projections (whether detailed plans or just a gut feeling) indicate tough times ahead, you need to start now to develop plans for dealing with declining revenues and/or declining profit margins.

If projections indicate that your business might operate at a loss for any period of time in the future, drastic plans are needed to avoid or limit losses and to identify the sources of funds to cover any losses.

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## Avoiding Losses

A key part of planning for tough times is knowing whether you can afford to operate the business at a loss. If there are no funds to cover losses, operating at a loss must be absolutely avoided.

Even if you have funds available to put into the business, this approach should be seriously considered in a downturn — and probably avoided. The permanent “investment” of funds typically only makes sense for a growing business. A “return on investment” can be obtained by investing in growth. Investing funds in a business to allow it to “survive” is ill-advised unless it is part of a coherent plan to increase profits and provide a return on the investment made.

What about loans to cover a short-fall in revenue? If money is borrowed to cover expenses, when will the business be able to pay that borrowed amount back? How long will it take to pay it back? If the business goes negative again in the future, how much more can the business borrow? Can the business afford to pay back an even greater loan amount?

If the business is running at a loss, does adding debt repayment to its list of payments make sense? Debt just drives a business into a worse situation.

Unless projections show that the amount of the loss in one period will be made up with profits from a future period, serious planning is necessary to make revenues successfully match expenses. What is needed is change that is “real.” Changes must be made to reduce

expenses or increase revenues to avoid losses. Any action that just covers the loss is allowing the circumstances to continue.

A one-time fix can be to accelerate income, if possible, and to defer payment of expenses, but that works basically one time (expenses can only be deferred to a certain point and then they become expenses for the next financial period. Income can only be accelerated to the point at which it becomes an advance payment.

## Putting Money Into The Business

When revenues drop below expenses, a number of things will happen, either intentionally or without any intention at all. Some bills will not be paid. Other payments will be delayed (hopefully to be paid from future income). Some commitments will not be kept. Funds will be borrowed. Business owners most often contribute funds to the business, either by putting money into the business, or by not taking a paycheck. Business planning must acknowledge that this step has been taken. This is not fixing the problem, but enabling it, to the detriment of the business and the business owner. If the business owner’s intent is to make an investment in the business because of opportunities to improve the business, a serious investment should be made that is consistent with an overall plan. Not taking a paycheck is not evidence of a serious plan.

A business owner naturally wants to put more money into the business if necessary to “meet payroll,” “keep

## THE IMPORTANCE OF FINANCIAL MANAGEMENT IN DIFFICULT TIMES

the doors open,” etc. However, putting additional money into a business that is not adequately profitable or is losing money only makes sense if there is a plan to fix the underlying problems or a plan of how to survive in a difficult economy.

A real plan acknowledges the amount of money that is needed. This isn't just an amount needed to keep the doors open for another month. The only amount of money that is worth investing is an amount adequate to implement a complete and doable business plan. If you are not investing in a good plan, you may just be “throwing good money after bad.”

In the past, businesses were often sold when the owners realized they were not managing the business profitably. Today, selling a business that is costing money rather than making money is not very realistic. In better times you might find an optimistic buyer willing to try to turn things around. Now optimism is in short supply, as are cash and willing lenders.

A business facing economic tough times needs to be adjusted to deal with circumstances. The easy outs of borrowed funds, invested funds, stretching out payments, and selling the business, don't offer solutions. They never really offered solutions, but a good economy kept businesses afloat. When the economy is not good, good financial management is imperative.

### Financial Management

When tough times become really tough, business owners should be

very motivated to take charge of financial information. Detailed and correct financial information is the key to determining what expenses to cut, where improvements can be made, and what changes should be made in rates, estimates, quotes, projections, and business relationships.

The plan for survival in tough times must address the following:

- Identification of what expenses will be cut.
- Calculation of how much total expenses can be reduced.
- Identification of sources of funds to cover shortfalls.
- Possible new rates or new estimating methods.
- Identification of new standards or procedures for estimating, bidding, or pursuing new projects.
- Whether any job with a risk of loss will be accepted. If the business is already risking loss or running at a loss, what possibility of additional losses is acceptable?
- Whether different pricing, terms, or other co-operative efforts could be pursued with suppliers.
- Whether different pricing, terms, or other co-operative efforts could be pursued with customers.
- Reduction of compensation to owners.
- Reduction of payroll and benefits. Consult with an employment attorney regarding actions involving employees. Make sure your actions comply with your employment policies and state and federal laws. Consider possible claims from employees.



*“In addition to looking at your financial challenges, consider the impact on your suppliers, subcontractors, competitors, customers, and potential customers.”*



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FROM THE LAW OFFICE OF MARY HANSON

## Publisher's Note

A business owner shouldn't expect the accountant or bookkeeper to point out financial problems in his or her business. The accountant or bookkeeper probably assumes the business owner sees what is happening directly - and that the business owner can understand the financial information.

Some accountants may provide assistance to the business owner by analyzing financial information and making recommendations for changes. Many accountants can assist the business owner in getting the business financial information faster and/or more accurately. Also to be considered is training for the business owner in understanding and using financial information.

Unfortunately, the accountant may be reluctant to offer additional services that will increase accounting costs to the business.

This makes it more important for the business owner to take "ownership" of financial information, getting more directly involved in financial management and the process of getting good information faster for the most help in business decision-making.

Mary Hanson  
Attorney/Publisher

## Other Steps

In tough times, everybody is affected. In addition to looking at your financial challenges, consider the impact on your suppliers, subcontractors, competitors, customers, and potential customers. In the "new environment" are there any new opportunities for your business? Could the higher cost of transportation present an advantage over your competitors who must ship their products? Could the lower value of the dollar give you an advantage with your foreign customers?

Consider what is happening to your competitors. Competitors who are "the same" as your business, based on size, location, employees and overhead, should be in much the same situation as your business. Consider whether your competitors

are similar to your business, or if they are much larger (and able to absorb losses over a long period), or smaller. Smaller businesses can have such low overhead that they are better able to survive — but unable to compete on a significant scale.

If you have competitors wooing your customers with unrealistic quotes in order to get work, you may be able to guesstimate whether this problem is likely to be a short-term problem or a longer term problem. Knowing who the competitors are and what kind of financial situation they are in should help you determine how long they can afford to compete in this manner.

Your own financial analysis is important in determining how to respond to competitive threats and selling opportunities. **BA**

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