

From ❤️ **Passion** to 💰 **Profits:**

Using the Numbers to Make it  
Happen for Your Business

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## It starts with passion...

Few owners start a business to satisfy a lifelong dream of being a paper pusher. Instead, they're inspired by a burning desire to sell the perfect Whimmy-Diddle\*, bake the world's richest gluten-free chocolate chip cookie, or save the world from the heartbreak of clogged drains. Or maybe they're simply looking to offer a better way: in *their* grocery store, customers will start shopping from the *left* instead of the *right*; in *their* gas station, customers will receive a discount for using a credit card. A business might take any number of different forms, but ultimately, it's passion that drives the owner to assume the risk and the responsibility (and hopefully the rewards) of starting his own business.

## ...but profit keeps it going.

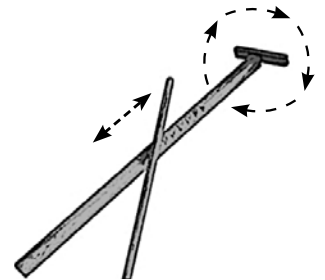
While it's passion that drives an owner to start a business, it's profit that sustains it. With enough passion, you might be able to corner the Whimmy-Diddle market or be the number-one unclogger of drains, but if you aren't covering your costs—except in the rarest of legal businesses—no amount of passion will keep you in business for long (the entrepreneurs who started Pets.com had plenty of passion plus a cool sock puppet but they failed to generate enough profit to survive beyond their second year). Without recurring profits, there is no business, and without accountability, there are no recurring profits. At some point, your passion for whatever you do turns into action, individual actions become transactions, and eventually, you need to take charge of those numbers. Once you get your business off the ground; you've got goods to receive, items to ship, and bills to pay...and you need to know where you stand to keep the doors open.

## Passion...by the numbers.

Can you feel your passion waning? Don't let it: making a profit doesn't have to mean pain and suffering—and you certainly don't have to abandon the passion that got you into business in the first place. However, you don't want to wake up one day to find your business and your passion buried under a mound of paperwork. You don't need to be the world's best bookkeeper; all it takes is a little knowledge of basic accounting concepts and a tad of organization to make sense of the numbers that will keep your business on track.

For many businesses, accounting is a chore. Once a year, they provide information to their accountant, who creates a tax return and maybe some financial reports. The information is historical and largely unintelligible. They don't understand their results and don't want to mess with daily accounting. But a system of accounting means more than a year end report—it provides management information that is critical to running a successful business, day in and day out.

This document will give you a new appreciation for accounting as a means of getting from passion to profits. We'll take a look at key concepts and see how they can apply to any business—including Whimmy-Diddles. By the time you finish this document, you'll have a clear understanding of how to get from **♥ Passion** to **💰 Profits**, one letter at a time.



*\*A Whimmy-Diddle is a mountain toy that consists of a propeller on the end of a stick, which you make rotate by rubbing another stick over the specially carved base of the first stick.*

## ♥ P is for Planning.

It all starts with a gleam in the eye or a fire in the gut. You've got a vision. You can see yourself doing something unique and hopefully needed and wanted by someone who's willing to pay for it. Or maybe the perfect opportunity has presented itself and you jump in with both feet. Either way, you need to put your vision in writing. A good plan with clear goals will keep the fires of your business passion burning. Without a plan, passion alone won't sustain you.

Start by identifying your long-term goal and describing what your business should look like in five years. Are you working to build a legacy, or do you want to sell your business in a few years? Will you sell products, provide a service, or both? And who is your ideal customer? Once you have these questions answered, you're ready to open your doors. Or are you?

*I love my Whimmy-Diddles. I want to create a Whimmy-Diddle empire making these handy devices from every known material in every color. I want to see a Whimmy-Diddle in every rockin' chair from here to the end of the Mason-Dixon line. I'm pretty sure everyone could use a little more fun in their lives. I want to build a business that stays in the family and ends up with Junior and his kin. I'm going to call the business Jimmy's Whimmies.*

## 💰 P is for Projection.

A strong passion and a clear plan is the foundation of a business. But without the nuts and bolts, your plan is just words on paper. The plan is the driver for everything that follows: How you structure your business, how you file your tax returns, how you manage your financial results on a monthly, quarterly, and annual basis, and who you hire and how you build your team. The next step is to take that vision and put pencil to paper to see how the numbers work:

1. First, you need to know how much it will take to cover your basic operating costs—like rent and utilities.

*For Jimmy's Whimmies, my fixed costs for rent and utilities are \$1,000 per month, which includes a nice little shade tree where my hound dog can rest.*

2. Then you need to understand the market to determine your product or service pricing.

*Based on my research from the Pumpkin Town Swap Meet and Craft Show, I can sell each Whimmy-Diddle for \$10.*

3. Next, you need to take a hard look at your product costs. It is the per unit spread between your price and your costs that will allow you to cover your operating costs.

*It looks like I can make these Whimmy-Diddles for a cost of about \$4 a piece using the recycled wood from outhouses. I'm looking for cheaper ways to do this down the road and hope to find materials that come without those little crescent-shaped holes in them.*

4. Finally, you need to estimate the number of units you will sell in a period to determine if you can generate a profit.

*When I get Mommer 'n em to join me in the craft fair booth, I can sell at least 100 units per event. Mommer knows how to sing and dance while making that propeller spin.*

5. Now do the math. Subtract your cost per item from your sales price. That is your per-unit profit. Multiply that number by your estimated unit sales to calculate your gross profit. Then compare that total to your operating expenses. If the gross profit exceeds your operating costs, you are expecting to produce a profit. If not, you need to change a piece of the equation—your expected price per unit, number of units, product costs, or operating costs.

If I sell each unit for \$10, and it costs me \$4 each to make them, using this new-fangled math, it looks like I can clear \$6 per unit. Taking my 100 estimated units at \$6 each makes my gross profit \$600. Dang, that's less than the \$1,000 a month I will be paying in rent to have my trailer on a lot. At that rate, I am going to be short \$400 a month.

Okay, if I have Junior dress up in his cowboy outfit and play the harmonica, I can push my unit sales up to 200 per month. Now I am covering my costs and making a profit of \$200 a month. That beats what I can earn peelin' potatoes.

You can plan overall financial results at a high level for the long term, but in the short term you should plan in more detail. Try to create monthly estimates for the next twelve months so you can turn your projection into a budget. This exercise not only helps you plan for each month, it also allows you to monitor your results as you go.

Jimmy's Whimmies											
Projection											
Income Statement											
		Year 1				Year 1	Year 2	Year 3	Year 4	Year 5	
		Jan	Feb	Mar	Apr	Total					
Sales	# Units	100	200	200	250						
	Avg Price per Unit	\$ 10.00	\$ 10.00	\$ 10.00	\$ 10.00						
Sales		\$ 1,000.00	\$ 2,000.00	\$ 2,000.00	\$ 2,500.00	\$ 22,500.00	\$ 50,000.00	\$ 75,000.00	\$ 100,000.00	\$ 150,000.00	
	# Units	100	200	200	250						
	Avg Cost per Unit	\$ 4.00	\$ 4.00	\$ 4.00	\$ 4.00						
Cost of Goods Sold		\$ 400.00	\$ 800.00	\$ 800.00	\$ 1,000.00	\$ 9,000.00	\$ 22,000.00	\$ 36,000.00	\$ 48,000.00	\$ 72,000.00	
Gross Profit		\$ 600.00	\$ 1,200.00	\$ 1,200.00	\$ 1,500.00	\$ 13,500.00	\$ 28,000.00	\$ 39,000.00	\$ 52,000.00	\$ 78,000.00	
Operating Expenses											
	Sales and Marketing					\$ -	\$ -	\$ -	\$ -	\$ -	
	Rent	\$ 900.00	\$ 900.00	\$ 900.00	\$ 900.00	\$ 10,800.00	\$ 10,800.00	\$ 10,800.00	\$ 10,800.00	\$ 10,800.00	
	Utilities	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00	\$ 1,200.00	\$ 1,260.00	\$ 1,323.00	\$ 1,389.15	\$ 1,458.61	
	Supplies					\$ -	\$ 1,250.00	\$ 1,500.00	\$ 1,500.00	\$ 1,500.00	
	Postage					\$ -	\$ -	\$ -	\$ -	\$ -	
Total Operating Expenses		\$ 1,000.00	\$ 1,000.00	\$ 1,000.00	\$ 1,000.00	\$ 12,000.00	\$ 13,310.00	\$ 13,623.00	\$ 13,689.15	\$ 13,758.61	
Net Income		\$ (400.00)	\$ 200.00	\$ 200.00	\$ 500.00	\$ 1,500.00	\$ 14,690.00	\$ 25,377.00	\$ 38,310.85	\$ 64,241.39	

Figure 1: Moving from a plan to a projection. A detailed projection can become your roadmap for generating those future business profits.

### ♥ A is for Assets

You've got a plan. The next step for a passionate business owner is to acquire stuff. You need a display case for your products, a computer for your accounting software, and a desk to work on. You might have inventory to sell and some cash that you have contributed to the business. Before you know it, you have gotten a hold of a bunch of business assets.

*I need a bunch of equipment for my Whimmy-Diddle business. There's the wood cutting machine and one o' them big fancy saws. I will have to pay extra for one of those plastic covers that prevent me from injurin' myself. I need to buy some wood and the best varnish money can buy. I don't know why, but I always feel better after a day of varnishin'...*

Assets are the foundation of a business. They include the cash that is needed to conduct business and the furniture and equipment that keep it functioning. Customer receivables and the inventory on your shelves are also valuable business assets.

Assets can be tangible (something you can touch, like a table or desk) or intangible (a concept or right, like a trademark or patent), but both types are important elements of a business. You will find them reflected on a financial statement called a **Balance Sheet**. Assets are recorded on the Balance Sheet at cost and, thanks to a system called double-entry accounting, their total cost will always equal the total of your Liabilities plus your Equity. (Automated accounting systems are designed to keep the transactions in balance for you, so when you print out your reports, they will be accurate.)

Assets represent amounts you own as of a specified point in time, while Liabilities represent amounts you owe. Equity ( sometimes called Capital or Net Worth) is the difference between your assets and your liabilities – it approximates the value of the business if you were to liquidate it as of a certain date.

Jimmy's Whimmies Balance Sheet March 31, 2011		
<b>Current Assets</b>		
Cash and Equivalents	36,775.11	
Receivables (Net)	187,408.84	
Other Current Assets	28,341.95	
Total Current Assets		252,525.90
<b>Property and Equipment</b>		
Property and Equipment	405,981.94	
Accumulated Depreciation	(182,603.03)	
Total Property and Equipment		223,378.91
<b>Other Assets</b>		
Organization Costs (Net)	2,995.10	
Other Assets	8,337.90	
Total Assets		\$ 502,237.81
<b>LIABILITIES AND CAPITAL</b>		
<b>Current Liabilities</b>		
Accounts Payable	\$ 71,729.21	
Accrued Expenses	3,022.55	
Taxes Payable	85,465.45	
Current Portion Long-Term Debt	5,167.00	
Contracts Payable- Current	2,000.00	
Other Current Liabilities	104.00	
Total Current Liabilities		167,488.21
<b>Long-Term Liabilities</b>		
Notes Payable-Noncurrent	4,000.00	
Total Long-Term Liabilities		4,000.00
Total Liabilities		171,488.21
<b>Capital</b>		
Stockholder's Equity	294,037.60	
Net Income	36,712.00	
Total Shareholders' Equity		330,749.60
Total Liabilities & Shareholders' Equity		\$ 502,237.81

*NOTE: Items are listed on the Balance Sheet in a specific order. The items that are most liquid (or most easily converted to cash) are at the top of each section, while the least liquid (or harder to convert items) are further down.*

*Assets always equal Liabilities and Equity*

 **R is for risk and rewards.**

Sometimes passion comes at a heavy cost. The higher the risk for the business owner, the higher the rewards he should expect. But how does the owner evaluate the rewards (or the return on his investment) in relation to the risk he assumes as the owner? And how does he avoid investing in too many assets?

It starts with those assets he has acquired. The assets are either used in the production of income or are converted directly into the income or loss that is then reflected on the **Income Statement**. When you sell assets from inventory, you do two things: 1) You generate revenue, and 2) You recognize the cost of goods sold. The difference between the revenue amount (or the sales price) and the cost of each item you remove from inventory is the profit in the business.

When you compare profit with the assets required to generate that profit, you gain valuable perspective. For example, if the business owner can generate \$100 of profit from a \$50 asset investment or \$200 of profit from a \$1,000 asset investment, which opportunity is better? He would divide the \$100 of profit by the \$50 asset investment to get a return of 200% in the first example, and divide \$200 of profit by the \$1,000 asset investment for a return of 20% in the second example. Based solely on the return on assets ratio that you have just computed, the first business opportunity is the better one (There could, however, be other outside considerations that make the second business more attractive).

$$\text{Return on Assets} = \frac{\text{Profit}}{\text{Average Asset Investment}}$$

In addition to comparing two possible investments, you can also use the return on assets formula to evaluate an owner's compensation for risk. When you compute the return on assets for a business and compare it to the return from alternate forms of investment, the resulting difference will be the owner's compensation for the risk of running the business.

*My first year's profit on Whimmy-Diddles is \$12,500*

*I have \$50,000 invested in assets including the wood and all of those saws and such.*

$$\text{My Return on Assets} = \frac{\$12,500}{\$50,000} \text{ or } 25\%$$

*Chuck over at Charles Schwab tells me he can get me a 10% return if I invest my \$50,000 in the stock market.*

*Now I compare the return on my business assets to the return I could get from putting the same money in the stock market.*

$$25\% - 10\% = 15\%$$

*I am making an extra 15% for the pain and suffering (not to mention the potential loss of a digit) of running this business.*

Only the owner can determine if he is receiving adequate compensation for the amount of risks he is assuming to run a given business.

The Return on Asset ratio is so important that it is often considered one of three bottom lines that should be monitored by a business owner. We'll talk more about the other two bottom lines later.

### **S is for Sales.**

Most business owners spend a great deal of time focused on sales. They set sales targets, monitor monthly results and look for every opportunity to close more business. In the first year, their focus is on generating sales. In the next year and every subsequent year, it's all about increasing sales, growing the top line, and adding more customers. Unfortunately, the passionate owner can get so excited about driving additional sales that he loses sight of the bigger picture –sales must not only be profitable; they must also be collectible. In a retail environment, all sales are made on a cash basis, so collectability isn't a problem. But in many other types of businesses, sales are made in exchange for a promise of payment. The goods or services change hands, and revenue is recognized on one date and the cash gets exchanged later. Uncollected sales can become bad debts for the business.

*I just got an order for 1,000 Whimmy-Diddles from the Five and Dime. They want me to send them an invoice when I send them my Whimmy-Diddles, and they promise to pay me in 30 days. That's \$10,000 in revenue for this month!*

Separating the exchange of goods and services from the payment is the main difference between a cash- and an accrual-basis method of accounting.

In short, owners need to keep their eye not only on sales, but also on profitability and cash flow to remain in business. So, how do you do this?

### **O is for Outstanding Receivables.**

When a company makes sales on account or extends credit to customers, amounts due from customers get recorded as Accounts Receivable. Proper management of those receivables is necessary to ensure that sufficient cash is available in the business. Good management involves clear credit policies, regular monitoring of balances due, and accuracy in shipping and billing.

*It's been 45 days, and I haven't received a payment from the Five and Dime. Meanwhile, I've had to pay for all the wood that went into those 1,000 Whimmy-Diddles.*

The total balance in receivables is reflected as an asset on the Balance Sheet as of a given point in time. One way to monitor the management of accounts receivable is to compute the Days Sales Outstanding. This ratio will show you how many days worth of sales are tied up in your receivables balance and are therefore not available as cash.

$$\text{Days Sales Outstanding} = \frac{\text{Total Receivables}}{\text{Total Annual Sales}}$$

An ending receivables balance of \$100,000 on annual sales of \$1,000,000 would represent 36.5 days of sales. Computed as:

$$\frac{\$100,000}{\$1,000,000} \times 365 \text{ Days} = 36.5 \text{ Days Sales Outstanding}$$

In cases where more than 90 days of receivables are uncollected, changes in credit policies or collection procedures should be considered. No amount of passion can make up for an absence of cash in a business. Without cash, the doors close.

### **S is for Service.**

Good customer service can turn a single sale into a lifetime of business. But it takes more than a passion for customers; it takes time and attention and often a good system to stay on top of customer needs, to manage return policies, and to empower your staff to handle any mishaps that occur in the course of operating your business. You need accurate records that include the correct contact information – including billing and shipping information and accurate inventory information so you can complete and fulfill a sale.

*The Five and Dime called. It seems they wanted 500 blue Whimmy-Diddles and 500 pink ones. We shipped them 1,000 black ones. I'll need to authorize a return and get the new products shipped out immediately.*

Excellent customer service requires more than passion for your products; it requires a well-run back office with good systems producing information that is accessible and understandable.

### **F is for Financial Statements.**

We've touched on financial statements, but here's the bottom line: financial statements tell the story of your business. Without them, you have no way to measure your results. The good news is that you don't have to be an accountant. The right system can organize all of your transactions and produce a series of financial statements that can show you and any outside investors how your business is being managed and where opportunities exist. Done properly, they can be the ultimate report card, providing valuable insights for planning.

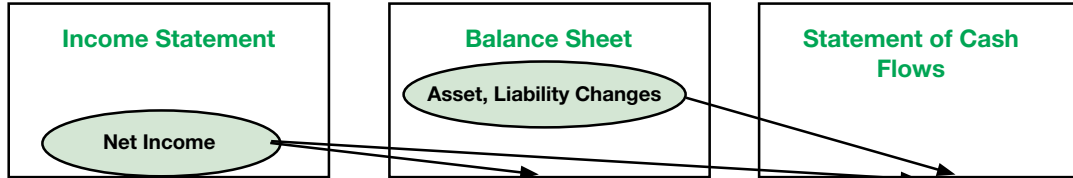
There are three financial statements and three bottom lines. The **Balance Sheet** tells the story of a business's ability to cover short and long term obligations, and through accumulated equity, shows how much the owners have invested in the business as of a point in time. The **Income Statement** reflects a company's management of income and expenses over a given period. The **Statement of Cash Flows** shows the owner where the money went. It starts with net income from the Income Statement and adjusts it by the sources and uses of funds to end up with the net change in cash for a given period of time.

**Three interrelated financial statements**

**Income Statement** – shows revenues and expenses over a period of time. At the end of each year, net income is added to the balance sheet and then reset to zero.

**Balance Sheet** – reflects what you own, what you owe, and your accumulated earnings in the business. Total equity is increased by the net income earned each year.

**Statement of Cash Flow** – starts with net income and adjusts it by changes in the balance sheet that create or absorb cash. It tracks cash produced by operating, investing, and financing activities of the business.



Jimmy's Whimmies Consolidated Income Statement For the Three Months Ending March 31, 2011				
	Current Month		Year to Date	
Revenues				
Sales	\$ 94,338.98	100.13	\$ 261,477.71	91.16
Other Income	0.00	0.00	25,500.00	8.89
Sales Discounts	(126.03)	(0.13)	(135.93)	(0.05)
<b>Total Revenues</b>	<b>94,212.95</b>	<b>100.00</b>	<b>286,841.78</b>	<b>100.00</b>
Cost of Sales				
Product Cost	19,547.29	20.75	68,488.93	23.88
Direct Labor	1,750.00	1.86	3,062.50	1.07
Materials Cost	6,790.85	7.21	7,540.95	2.64
Subcontractors	335.50	0.36	335.50	0.12
<b>Total Cost of Sales</b>	<b>28,423.64</b>	<b>30.17</b>	<b>79,447.88</b>	<b>27.70</b>
<b>Gross Profit</b>	<b>65,789.31</b>	<b>69.83</b>	<b>207,393.90</b>	<b>72.30</b>
Operating Expenses				
Freight	0.00	0.00	50.00	0.02
Advertising Expense	1,325.00	1.41	1,325.00	0.46
Auto Expenses	274.56	0.29	274.56	0.10
Bad Debt Expense	1,292.10	1.37	1,292.10	0.45
Bank Charges	18.00	0.02	18.00	0.01
Depreciation Expense	2,761.30	2.93	8,394.00	2.93
Legal and Professional Expense	90.00	0.10	450.00	0.16
Licenses Expense	150.00	0.16	150.00	0.05
Maintenance Expense	75.00	0.08	75.00	0.03
Office Expense	479.89	0.51	479.89	0.17
Payroll Tax Exp	5,130.71	5.45	15,392.13	5.37
Rent or Lease Expense	550.00	0.58	1,100.00	0.38
Repairs Expense	50.00	0.05	3,619.00	1.26
Supplies Expense	2,873.42	3.05	2,873.42	1.00
Utilities Expense	303.45	0.32	303.45	0.11
Wages Expense	44,809.52	47.56	134,428.56	46.87
Other Expense	664.90	0.69	664.90	0.16
Purchase Disc- Expense Items	(8.11)	(0.01)	(8.11)	0.00
<b>Total Operating Expenses</b>	<b>60,639.74</b>	<b>64.36</b>	<b>170,681.90</b>	<b>59.50</b>
<b>Net Income</b>	<b>\$ 5,149.57</b>	<b>5.47</b>	<b>\$ 36,712.00</b>	<b>12.80</b>

Jimmy's Whimmies Balance Sheet March 31, 2011	
Current Assets	
Cash and Equivalents	36,775.11
Receivables (Net)	187,408.84
Other Current Assets	28,341.95
<b>Total Current Assets</b>	<b>252,525.90</b>
Property and Equipment	
Property and Equipment	405,981.94
Accumulated Depreciation	(182,603.03)
<b>Total Property and Equipment</b>	<b>223,378.91</b>
Other Assets	
Organization Costs (Net)	2,995.10
Other Assets	8,537.90
<b>Total Assets</b>	<b>\$ 502,237.81</b>
<b>LIABILITIES AND CAPITAL</b>	
Current Liabilities	
Accounts Payable	\$ 71,729.21
Accrued Expenses	3,022.55
Taxes Payable	85,465.45
Current Portion Long-Term Debt	5,167.00
Contracts Payable- Current	2,000.00
Other Current Liabilities	104.00
<b>Total Current Liabilities</b>	<b>167,488.21</b>
Long-Term Liabilities	
Notes Payable-Noncurrent	4,000.00
<b>Total Long-Term Liabilities</b>	<b>4,000.00</b>
<b>Total Liabilities</b>	<b>171,488.21</b>
Capital	
Stockholder's Equity	294,037.60
Net Income	36,712.00
<b>Total Shareholders' Equity</b>	<b>330,749.60</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>\$ 502,237.81</b>

Jimmy's Whimmies Cash Flow Statement For the three months ended March 31, 2011	
	Year To Date
Sources of Working Capital	
Net Income	\$ 36,712.00
Add back items not requiring working capital	
Accumulated Depreciation	8,393.90
<b>Cash Basis Net Income</b>	<b>45,105.90</b>
Increase in AR	(183,383.54)
Inventory Increase	16,680.93
Accounts Payable	67,826.46
Sales Tax Payable	16,567.22
401 K Deductions Payable	1,964.85
Health Insurance Payable	(530.64)
Federal Payroll Taxes Payable	39,206.76
State Payroll Taxes Payable	5,733.51
Other Current Liabilities	200.00
<b>Operating Cash Flow</b>	<b>9,431.45</b>
Beginning Cash Balance	27,343.66
<b>Ending Cash Balance</b>	<b>36,775.11</b>

*Thanks to my automated accounting software, I can generate all three financial statements with a push of a button. That means I can keep tabs on my profitability, monitor asset balances, and review my cash flows. My Whimmy-Diddle empire is within reach.*

Each financial statement provides different insight into the business through different bottom lines. Net Income is the bottom line for the Income Statement, which shows how profitable a business has been. Return on Assets (mentioned earlier) is the bottom line for the Balance Sheet. It tells the owner how well he has managed his assets in the production of profit.

Operating Cash, reflected on the Statement of Cash Flows, is the third bottom line.

It tells the owner if his current operations are producing enough cash to run the business. It also tells a potential lender whether the business can generate enough cash to repay debts.

Financial statements are an important tool for an owner to use in managing his business. They provide valuable insights and are the basis for decision making and planning.

## ♥ I is for Inventory.

If you sell products, you need inventory. Items get added to inventory at their purchase cost and are removed from inventory at the time of sale. Having sufficient inventory on hand is a key to providing good customer service, while carrying too much inventory can increase your costs and consume valuable cash. Inventory management is a delicate balancing act, especially for an owner who is passionate about producing and selling products.

*I found a great crop of Juniper trees that look like they will produce a mighty fine spin on my Whimmy-Diddles. I think I'll order enough Juniper wood to fill up my warehouse; I don't want to run out of wood just before the Christmas rush.*

It takes more than just inventory to run a successful business. It takes the right mix of the right product at the right time.

## 💰 I is for Inventory Turns.

You have inventory on your shelves. You've got the latest products in every imaginable color. Or maybe you have different varieties, different sizes, or a million different items. Now you need a way to evaluate your management of what can quickly become your largest business asset: inventory. The key is to look at the frequency with which items move from your shelves to your customers. From a financial statement perspective, that means you want to track the movement of inventory from your Balance Sheet to cost of goods sold on your Income Statement.

You can calculate Inventory Turns to get a handle on your overall inventory management.

$$\text{Inventory Turns} = \frac{\text{Annual Cost of Items Sold (Income Statement)}}{\text{Average Inventory on Hand (Balance Sheet)}}$$

The higher the result, the more effectively you are managing your inventory. You might want to compare your results with others in your industry for additional insights.

*I am selling about 20,000 Whimmy-Diddles a year. My cost of goods for those items is \$80,000. That Juniper wood sitting in my warehouse cost me \$400,000. My inventory turns are 80,000/400,000 or .20. That can't be good.*

The inventory turn ratio is a valuable tool in converting your business passion into a profitable business.

## ♥ O is for Orders.

It's exciting when orders start flying in the door. You barely have time to capture all of that customer information when the next order appears. But orders have to be fulfilled, product needs to be shipped and bills need to be mailed.

*I just got an order for 50 orange Whimmy Diddles with the Clemson Tigers logo. I'm charging \$20 each for these, on account of the special art work. I'll just set this order a side for a minute and take that call from my next customer.*

You can have two types of orders in a business: Customer orders, which reflect future sales, and Purchase orders, which reflect future expenditures. Customer orders can stack up when you don't have sufficient items on hand to meet customer demands. Once you have sufficient inventory to ship the goods, the order becomes an invoice. Without a good system, it's easy to lose track of open orders, since neither goods nor dollars have been exchanged. Lost orders are a surefire way to kill passion – for both owners and their customers.

*Now where did that order go? I remember a phone call last week that had something to do with a Tiger logo. And I think I ordered a batch of varnish from my favorite supplier. But I don't remember when they were gonna deliver it.*

Purchase orders are typically sent to vendors and suppliers to authorize a purchase of goods or services. Once you receive any ordered goods or services, the purchase order becomes a payable of the business. In order to stay on top of future cash requirements, you need an accurate record of outstanding purchase orders at any point in time.

Successful businesses need to keep track of both open orders and outstanding purchase orders.

**T is for Tracking.**

When you are passionate about your business, you can take orders, sell products, move inventory in and out, write checks and collect payments. But at the end of the day, if you want to be successful in business, you need a way to track your progress. You need to know if you are earning enough profit to cover your costs, if you are managing your assets and liabilities wisely, and if you are generating enough cash to fund your business. You need a system that organizes your transactions and turns data into information. You can set up manual systems to keep track of your transactions or an automated solution like Sage Peachtree to manage the transactions for you.

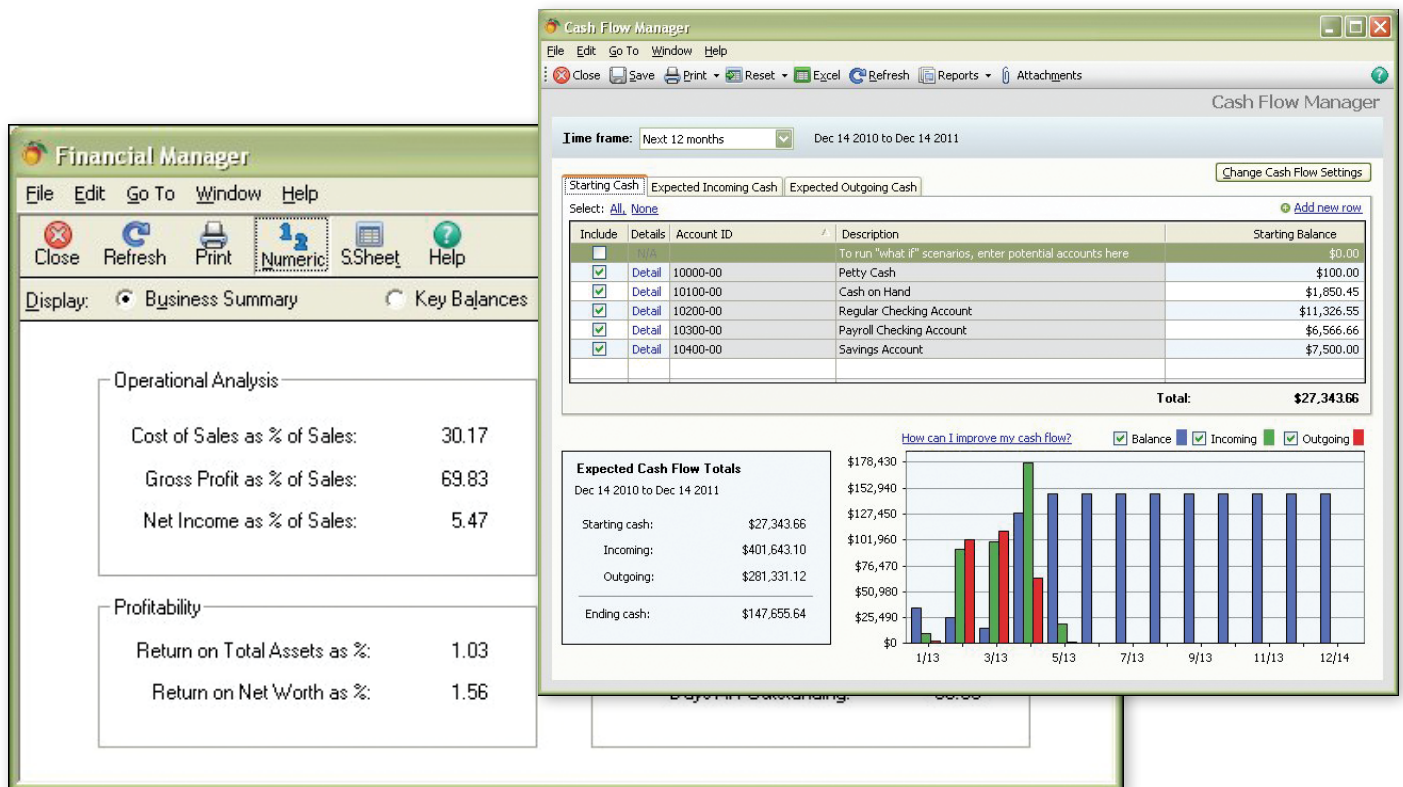


Figure 2: Financial and Cash Managers.

Thanks to transaction tracking, I can see how much cash is expected to come in and how much needs to go out. I can review my profitability and inventory turnover. No Whimmy-Diddle will be left unshipped.

Either way, you need to have a handle on your transactions in order to have timely reporting and regular financial statements.

**♥ N is for Net Income.**

Who doesn't love showing a profit? Every business owner knows that Net Income is important. It is the bottom line on the Income Statement and the one figure on his financial statements that every owner knows to check. Net Income is the first bottom line.

*Well, I'll be. We had a good month. This Income Statement of mine shows Net Income of \$5,000 this month. But why don't I have any money in the bank? And how come I have so many Whimmy Diddles sittin' on the shelves in my warehouse?*

To have positive net income, you need to have products priced at the right level and sell sufficient units to cover your costs. You also need to monitor operating expenses and weigh the cost of sales and marketing efforts against sales results. Income statement management is critically important. But it's just one part of managing a profitable and successful business.

 **S is for Sustainable.**

A sustainable business requires more than a short term focus on Net Income. You need first to generate gross profit, then net income to have a healthy Income Statement. But you also need to manage assets like accounts receivable and inventory, stay on top of liabilities like accounts payable and loans, and manage cash flow. You need to reinvest your earnings in the business every year and pay attention to customer trends and forecasts. A business that is successful in the long term results from properly managing all three financial statements. These statements can help an owner organize the transactions that go into running a business so they lead to valuable insights and better business decisions.

*I've got good records, timely financial statements, and a system that makes it easy to stay organized. My Whimmy-Diddle business is generating profit and cash plus a decent return on my assets. I am confident that Jimmy can keep the business on track and even expand into new markets. In no time at all, he'll be converting those yoga enthusiasts on the West Coast into Whimmy-Diddlers.*

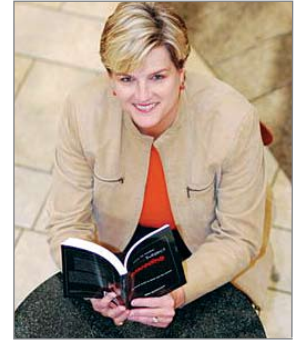
**The journey is complete.**

Passion is a vital component of business success. Without a firm commitment and plenty of motivation, few business owners would be able to endure the ups and downs of running their own business. But passion without a purpose is a hobby, not a business.

In this document, we've tried to explain some of the tools and techniques that can help you harness that passion and channel it towards long term business success. We've taken you through planning and asset acquisition, talked about the importance of sales and service, touched on inventory and orders, and wound up with Net Income. **Passionate** businesses need all of those elements. But **profitable**, long term business owners need those elements and more. They need to turn their plan into a detailed projection, they need an understanding of their risk/reward trade-off, and they need to measure outstanding receivables, produce and monitor their financial statements, review the movement of their inventory, and keep track of everything in an organized way. Passionate owners want to build a sustainable business, and to do that, they need a solid foundation built on three financial statements with three bottom lines: Net Income, Net Operating Cash, and Return on Assets.

THE ROAD FROM PASSION TO PROFITS.			
<b>P is for Planning.</b>	You need a written plan for your business.	<b>P is for Projection.</b>	A Projection can translate your passion into measurable goals and objectives.
<b>A is for Assets.</b>	Assets are the foundation of a business.	<b>R is for Risk and Rewards.</b>	A successful business generates a healthy Return on Assets that provides ample reward for the risks assumed by the owner.
<b>S is for Sales.</b>	You need to generate sales to stay in business.	<b>O is for Outstanding receivables.</b>	Days receivables outstanding is a measure for managing your accounts receivable balance.
<b>S is for Service.</b>	Good service requires supporting systems.	<b>F is for Financial Statement.</b>	You can monitor your business results in one of three standard financial statements.
<b>I is for Inventory.</b>	You need items to sell in a business.	<b>I is for Inventory Turns.</b>	Inventory turns help you evaluate inventory management.
<b>O is for Orders.</b>	Orders represent future sales and future expenditures.	<b>T is for Tracking.</b>	You need a way to keep track of your business results.
<b>N is for Net Income.</b>	Net income is the first hurdle for a business owner.	<b>S is for Sustainable.</b>	Sustainable businesses manage all three financial statements and all three bottom lines.

**About the author:** Geni Whitehouse is a CPA and speaker and the author of “How to Make a Boring Subject Interesting: 52 ways even a nerd can be heard”. Originally from Greenville, South Carolina, Geni now resides in Napa, California. When she’s not busy playing with her Whimmy-Diddle or avoiding those gluten-free cookies, she’s busy tweeting, blogging, speaking, and writing articles on technology and communication for [www.theprogressiveaccountant.com](http://www.theprogressiveaccountant.com).



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