

FORESIGHT

CONTEMPORARY IDEAS FOR BUSINESS MANAGEMENT

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FINANCIAL TIPS

Getting a Loan Despite the Credit Crunch



The financial crisis that hit the U.S. economy in 2008 is continuing to negatively impact the commercial credit markets, resulting in an ongoing business credit crunch.

Over the past 15 to 18 months, most banks have tightened their lending standards in order to reduce their risk exposure. This has made it hard for even some well-established and creditworthy businesses to get the financing needed for working capital, expansion or growth. Companies in search of financing today must do everything they can to position themselves favorably in the eyes of banks and other lenders.

FOCUS ON THE FIVE C's

In the current environment, most banks are returning to their

traditional emphasis on a borrower's character, capacity, collateral and capital, along with current market conditions. As you prepare to approach your bank to discuss financing, do some self-evaluation to see how your business measures up in each of the following five areas.

Character: Do you and your managers have a strong reputation in your community and industry in terms of how you treat customers and employees? Are you willing to take responsibility for your actions

and their outcomes without making excuses? Do you do what you say you're going to do, when you say you're going to do it?

Capacity: Cash is king. It's a cliché, but more true today than ever before. There's simply no substitute for strong cash flow. Lenders want to know what is driving your cash flow and how stable and dependable it is. They will look for cash flow patterns — positive or negative — and try to determine future trends.

To help gauge your capacity, your banker will try to determine how much debt your business can assume (this is known as your debt service capacity) by calculating a variety of financial ratios and comparing them to industry benchmarks. Examine your current debt load before approaching a lender to ask about additional financing.

Capital: Most lenders want to know if you are personally invested in the business with some of your own money — or in other words, what you have at risk. They like to see that owners have “skin in the game” before making a loan.

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The Importance of Strategic Planning

Most business executives are familiar with business planning and the creation of a business plan. But what about *strategic* planning?

Contrary to popular belief, business and strategic planning are not the same thing. In fact, they're quite different. Not understanding this is one of the main reasons why companies sometimes fail to execute their seemingly well-thought-out business plans.



STRATEGY VS. TACTICS

To better understand the difference, consider a sports analogy: A football coach might decide that his team's best chance to defeat its next opponent is to run the ball as early and as often as possible. This would be the team's strategy. The specific mix of tactics, such as running and passing plays called during the game, would constitute the game plan.

Put another way, strategic planning is about the big picture, while business planning is about the tactics that will be implemented in order to reach the vision and goals outlined in the strategic plan.

The strategic plan should be created and implemented before

a business plan is developed. Otherwise, there's no foundation on which to base tactical steps. The strategic plan should help identify your company's:

- **Vision.** Where do the owners and executives see the company one, three, five and even 10 years down the road?
- **Goals.** What are your short-, medium- and long-term objectives?
- **Mission and values.** Why does your company exist? Dig deep to identify your core reason for existence beyond just making money or delivering a product or service. Create a short, concise mission statement that captures your reason for existence. Make sure it's easy to remember and can be spoken in clear, plain English — not corporate-speak.

EFFECTIVE PLANNING

There is no one-size-fits-all approach to strategic planning. Each organization should devise a process that works best given the personality of its employees and the corporate culture. However, these general guidelines can help any company implement a strategic plan more effectively:

Do it yourself. Strategic planning isn't something you can outsource to a consultant. It's a personal process that should involve all of your key employees and stakeholders. The development process itself is often as valuable as the final document.

Bring in an outside facilitator. It might make sense, however, to bring in an outsider to help facilitate planning sessions. An impartial individual brings a fresh perspective and

can see things that you and others inside of your organization miss.

Keep an open mind. Avoid summarily dismissing new ideas or concepts that might seem too far out of the box. Be open to throwing everything against the wall to see what sticks.

Get away. The strategic planning process will likely be an in-depth, roll-up-your-sleeves session that is difficult, if not impossible, to accomplish amid the everyday hustle and distractions of your workplace. Plan on getting away from the office for all or part of a day or two, whether it's out of town or just around the corner.

Be flexible and adaptable. A strategic plan should not be a static document. Rather, it should change along with business conditions and your company's environment. A strategic plan from two years ago, for example, would probably need revisiting today given the tremendous upheaval in the economy and financial markets over the past couple of years.

Make it organization-wide and bottom-up. To be most effective, a strategic plan should incorporate input from everyone in your organization. While it may not be practical to involve all your employees in the details of the planning process itself, you should at least solicit everyone's opinion on the company's vision, goals and values.

As the saying goes, it's awfully hard to push a rope. Top-down plans that don't have buy-in from all levels in your organization are doomed to fail. ❖

For help strategizing your company's future, contact our office.

Getting a Loan Despite the Credit Crunch

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Collateral: Almost all loans (especially nowadays) require that borrowers pledge a secondary source of repayment, or collateral, in case the loan itself cannot be repaid. Banks usually like to see hard assets, like real estate and equipment, pledged as collateral because these are easier for them to convert into cash if the loan is not repaid. If yours is a service business without hard assets, you may be required to pledge personal assets as collateral — most likely, your home.

Conditions: In evaluating your loan request, lenders will consider the general economy and your specific industry. While general economic conditions today are less than ideal, the situation in certain industries is better than others — a factor that could work in your favor. Lenders will also focus on your company's ability to withstand short-term financial adversity, primarily by looking at how liquid you are.

AND NOW, THE TWO P's

In addition to the five C's of credit, there are two P's you should also consider: proactivity and preparation.

Some business owners only approach their bank when they need to borrow money. Instead, be proactive by establishing a relationship with your banker long before you need a loan. Your banker has probably worked with other businesses in similar situations and can therefore provide assistance and advice beyond just a business loan.

Also, be prepared to meet with your banker. Do you know specifically why you need to borrow money, how much money you need to borrow, and when and how you intend to repay it? Are you prepared to discuss any collateral you can pledge? Bring detailed

financial information to your meeting, including both business and personal tax returns, financial statements (see “The Role of Financial Statements” below) and your business plan.

All financial records and information should be up to date. This includes a current listing of accounts receivable agings and details of your most recent collections efforts. Be prepared to demonstrate adequate accounting, bookkeeping and internal control systems, as well as accurate sales and cash flow forecasts that are based on reasonable and realistic assumptions.

PERSISTENCE PAYS

While the lending environment has changed drastically over the past couple of years, the fact remains that there are lenders prepared to entertain and approve loan requests for

companies with strong management, a viable core business and a solid strategic plan. (See page 2 for more on strategic planning.)

In fact, financially strong companies may find themselves in an advantageous position. Banks, after all, are still in business to loan money, and the less risk they perceive in a company, the more attractive they will view the credit.

Finally, keep in mind that in the current economic environment, it's impossible to over-communicate with your banker. Keep him or her informed about every relevant development at your business, whether it's good news or bad news. And remember: Bankers hate surprises. ❖

Contact our office today to discuss how we can help you prepare the strongest possible case for financing.

The Role of Financial Statements

Lenders will want to see three primary financial statements as they evaluate your loan request:

- **Balance sheet:** This is a snapshot of your company's financial position at any time, reflecting what your company owns (your assets) compared to what it owes (your liabilities).
- **Income statement:** Also known as a profit and loss statement (P&L), this tells you how much money you made or lost during a given period of time (usually a month, quarter or year).
- **Cash flow statement:** This final component ties the balance sheet and income statement together, reconciling the change in your cash position from the beginning to the end of the period being measured (usually a year). It tells you where cash came from and what happened to it.

Tip: Don't look at your financial statement numbers in isolation. Compare them from quarter to quarter and year to year to look for trends that can help you improve financial management.

A Case Study: Small Business Fraud

This is the second article in our series examining internal fraud.

For a real-life look at how internal fraud can impact a company, consider the case of an optometrist who found out that his business lost \$48,000 over 14 months when one of his employees was given too much control over cash receipts. Unfortunately, this story is common.

In this case, the employee received payments from customers, recorded them in the ledger, prepared the bank deposit, and took the deposit to the bank. The optometrist-owner provided little to no oversight, because he trusted her.

“What about the bank reconciliations?” you might ask. “Who was

doing them?” As it turns out, no one was. It was all too simple. The employee deposited all the checks into the bank account and put all the cash in her pocket — every day. She did some fancy accounting in the general ledger to cover it up, but with no oversight, even that wasn’t necessary.

She only got caught because one day someone noticed the cash was still in the drawer after she returned from the bank. She had forgotten to put it in her pocketbook — oops. A simple slip-up like this is how most business frauds are discovered. The employee ended up pleading

guilty to felony cash larceny.

It’s easy to think this was possible because the business was small and unsophisticated. However, most frauds are amazingly simple, making the size of the business irrelevant.

A lack of basic internal controls creates the opportunity for fraudsters to get away with their crime. The biggest deterrent to someone who might want to commit fraud is simply knowing that someone is looking over their shoulder. ❖

The sooner you safeguard your company, the better. Let us help you prevent costly fraud.



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