By LESLIE SHINER

THE DR. IS IN!

Leslie Shiner has the financial advice for what ails you.

There are two ways to run a small business today—one by the seat of your pants and the other by the numbers. In the past, with the significant margins on equipment and minimal competition, an electronic systems contractor (ESC) could succeed by running the business by the seat of his or her pants. But not anymore. I predict that those companies will not survive; the only companies that will be around next year are the ones that understand their numbers and use financial information to make informed, strategic decisions.

In this series, we'll be looking at how to use your financial statements to manage your business. Many companies only generate financial statements to give to their accountant for tax returns, but we'll see how creating and analyzing monthly financial statements can provide the information you need to make decisions. For example, if your volume is falling and you are being pressured by customers to reduce your prices, how low can you go? The only way to answer this question is to have accurate financial statements.

Analyzing Statements

The first step is to look at your Profit and Loss Statement (P&L) or Income Statement. All costs should be split into two categories, costs directly related to the job (Cost of Goods Sold-COGS) and overhead costs. It sounds simple, but I can't tell you how many times I've seen financial statements that are a mess. All too often, companies do not track production labor to specific jobs. They complain that it's too hard to get time cards, or the system won't track job costs. My first response is: "who's running your company, you or your employees?" Second, all systems, even QuickBooks, will job cost your payroll, but only if you set it up to do so.

However, even with the best intentions, it still may be hard to interpret your P&L. In this industry, the difficulty occurs because the timeframe of your financial statements may not match the timeframe of the jobs. In order to create accurate P&L statements, you need to consider an accounting standard called the "Matching Principle" in which the amount of income you show is related to the costs that you've actually incurred. This means that if the COGS on your P&L shows 25 percent of the expected costs of a job, you should show 25 percent of the expected revenue and then be able to show 25 percent of the expected gross profit. This is the only way to make your financial statements meaningful.

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What Money Belongs to You?

This is extremely important in this industry. If you receive customer deposits and count that money as income, you may be fooling yourself into thinking you are more profitable than you actually are. When you receive money in advance of a job, that money is not really income; you didn't do anything to earn it. Customer deposits are a liability; you either owe the customer a refund or a service and/or product. When your volume increases, the amount of cash you collect increases. But when your volume decreases, there is no new money flowing into the company—if you've already spent the money you received for today's job to finish yesterday's job, then you are in trouble. When you sign more and more contracts, and collect more and more dollars up front, if you use that money for prior jobs, then you are in essence perpetuating a Ponzi scheme—similar to the stories we hear in the news today. These schemes can continue without being detected in a good economy, but in a slowing economy, in a company where the number of signed contracts today is less than yesterday, that's when you get caught. Therefore, I ask you this question: Do you know how much money you've collected that doesn't actually belong to you? If not, then you need to fix your financials so they speak to you and tell you what you need to know.

Many good ESCs who provided excellent service and created fabulous living spaces have gone out of business. I predict we haven't seen the end of this. But if you want to weather this economic storm, you'll need to use the tools necessary to stay in business. You need to clean up your financial act.

Throughout the coming months, I'll discuss ways to improve your financial health. With an accurate P&L, accurate job costing and a clear understanding of your overhead, you'll be able to answer the question of how low can you price the job and still be in business. Next time, we'll discuss Markup and Margin, and how to use your P&L to determine pricing. But before that, I caution you to compare the cash you have on hand with the amount you've collected from customers. Be careful not to spend tomorrow's dollars for today's jobs. **CR**

Leslie Shiner is a financial and management consultant. She is the owner of the The ShinerGroup, a consulting firm helping businesses maximize profits and gain financial control. She manages CEDIA's Survival of the Fittest Program and has received the CEDIA Top 10 Instructor Award multiple times. She can be reached at L_Shiner@ShinerGroup.com.