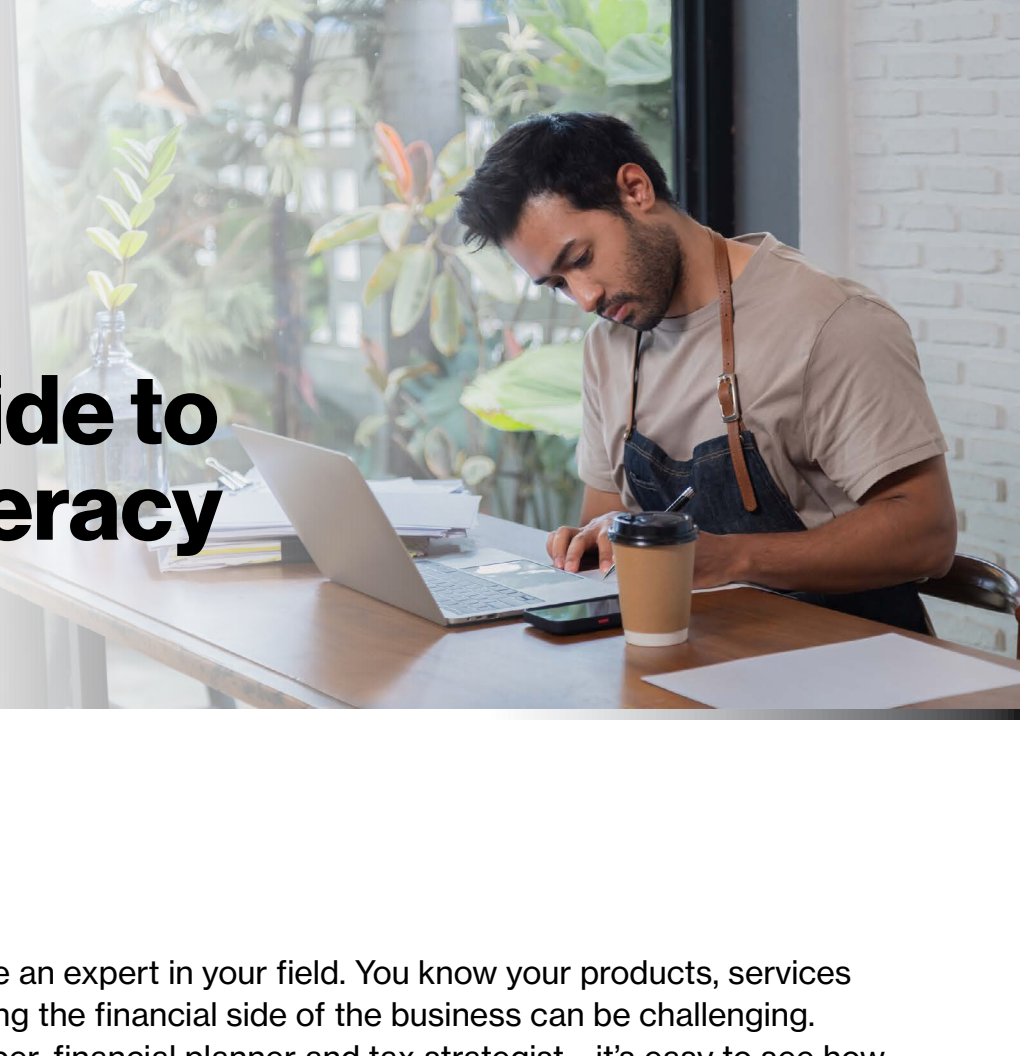


# The small business owner's guide to financial literacy



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As a small business owner, you're an expert in your field. You know your products, services and customers well. But navigating the financial side of the business can be challenging. Suddenly, you're also a bookkeeper, financial planner and tax strategist – it's easy to see how the financial side of the business could get lost in the shuffle.

Yet, understanding your business' financial health is essential to [making informed decisions](#) that can help drive growth and long-term success. Learning the basics of budgeting, strategic financial planning and financial statements may help you develop essential financial skills. This guide to financial literacy can help you build the confidence to manage your business' finances better.

## What is financial literacy?

Small business owners often juggle countless responsibilities – from salesperson to customer service representative. That includes financial tasks, too. Financial literacy isn't just about balancing a checkbook or knowing how to file taxes. It's a comprehensive set of skills that can help you make more informed decisions about your business' financial future. From developing a budget to crafting strategic financial plans and understanding financial statements, financial literacy gives you the tools to navigate your finances confidently.

Building an understanding of financial literacy as a small business owner might help you build a sustainable business that can last and thrive for years. Here's why:

- It helps inform decision-making, equipping you with the insights to evaluate options, assess risks and choose the best path forward.
- By understanding your financial statements, you can identify areas of opportunity or potential red flags.
- Learning about financial risk helps you proactively implement strategies to protect your business from unexpected events.
- You can develop a financial plan that may help you improve cash flow, increase revenue and reduce costs to improve your bottom line.
- You can confidently communicate your business' financial health if you're trying to secure funding or attract investors.

## Creating a budget for your business

Creating a budget might seem tedious, but consider it your financial game plan. A well-crafted budget can serve as your financial road map for your small business, which you can use to start anticipating challenges and capitalizing on opportunities. It helps allow you to:

- Forecast revenue: Estimate how much money you can expect to bring in over a given period.
- Control expenses: Identify areas where you might be able to cut costs and improve efficiency.
- Allocate resources strategically: Help ensure you have enough funds to invest in growth initiatives.
- Prepare for the unexpected: Build a buffer for emergencies or economic downturns.

There's no one-size-fits-all approach to budgeting. The ideal budget for your business depends on your industry, size, revenue model and growth stage. Working with a financial professional can help. However, there's a general step-by-step approach to get you started:

1. Set financial goals: What do you want to achieve with your business? Whether it's increasing revenue, reducing debt or expanding operations, clearly define your financial objectives.
2. Gather historical data: Review your past financial statements to understand your revenue and expense patterns. This historical data can provide a foundation for your budget.
3. Forecast revenue and expenses: Project your future income and expenses based on your goals, historical data and market trends. Be realistic and consider potential fluctuations.
4. Categorize your expenses: Divide your expenses into fixed costs (like rent, salaries and insurance) and variable costs (like advertising, supplies and utilities). This can help you identify areas where you can cut back or fund more liberally.
5. Monitor and adjust: Regularly review your budget and compare it to your actual results. Identify variances and make adjustments as needed. Your budget should be a living document that evolves with your business.

## Budgeting pitfalls to avoid

Even with the most careful planning and good intentions, managing a budget can be challenging, especially if you're new to it.

Remember, budgeting for small businesses is an ongoing process. By regularly reviewing your budget and making adjustments as needed, you can put yourself in a great position to stay on top of your finances and keep your business on track for success. Here are some common mistakes to watch out for:

- Overestimating revenue: It's easy to get caught up in optimism, but be realistic about your sales projections. Base your estimates on historical data and market conditions.
- Underestimating expenses: Unexpected costs can quickly derail your budget if you're not prepared. Build in a buffer for contingencies, and be sure to include all expenses, both large and small.
- Ignoring cash flow: Even profitable businesses can face cash flow problems if they don't manage their income and expenses effectively. Ensure you have enough cash on hand to cover your obligations.
- Underspending during slow periods: It's tempting to cut back on expenses during lean times, but be careful not to sacrifice essential investments that could fuel future growth, such as marketing or sales.

## Build a financial plan for the long term

A financial plan can be your long-term road map to success. Use it to outline your vision for the future, set clear financial goals, and detail strategies to achieve them.

### Why you may need a financial plan for your small business

A comprehensive financial plan is not just for large corporations; it can also be a critical tool for small businesses and part of a business owner's financial education. It guides decision-making, helping you allocate resources effectively, secure funding and measure your progress over time. Whether you aim to expand your operations, launch a new product line or ensure your business' long-term sustainability, a financial plan can provide the structure and direction you need.

A well-constructed financial plan can provide plenty of benefits including:

- Strategic decision-making: Clearly define your financial goals and identify the resources needed to achieve them to help you make informed decisions about where to invest your time and money.
- Securing funding: Lenders and investors may want a clear and realistic financial plan before committing resources. Having this plan shows you're serious and committed to your business.
- Measuring progress: A financial plan provides benchmarks for measuring actual performance, allowing you to identify areas where you're doing well and where you need to adjust.
- Attracting and retaining talent: A solid financial plan helps determine what salaries, bonuses and benefits your company can offer employees, making it more attractive to jobseekers.

### Develop and maintain your financial plan

A financial plan is a road map for your business, guiding you toward goals, helping you secure funding and potentially making it easier to measure progress over time.

Remember, your financial plan is not set in stone. As your business evolves and market conditions change, you may need to regularly review and update your plan to ensure it remains relevant and effective. Here are the key steps involved:

1. Set clear goals: Start by defining your short-term and long-term financial objectives. What do you want to achieve in the next year? Five years? Ten years? Be specific and measurable.
2. Assess your current financial situation: Analyze your financial statements to understand your starting point. This includes reviewing your income, expenses, assets, liabilities and cash flow.
3. Develop financial projections: Based on your goals and current financial situation, create projections for your revenue, expenses and cash flow over the next few years. Consider different scenarios, such as best-case, worst-case and most likely.
4. Identify funding needs: Determine how much funding you'll need to achieve your goals. This may include securing loans, attracting investors or reinvesting profits into the business.
5. Develop strategies: Outline the specific actions you'll take to achieve your financial goals. This may include marketing initiatives, cost-cutting measures, pricing strategies and investment decisions.
6. Create contingency plans: Prepare for unexpected events, such as economic downturns or industry disruptions. Having a backup plan can help you weather storms and stay on track.

## Understand your business' financial statements

Financial statements can be the foundation of your business' health. Small business financial literacy means knowing how to read and interpret these statements to clearly understand your company's financial performance, strengths and weaknesses. Any guide to financial literacy needs to include an overview of these critical documents and what they mean for your business.

There are the three core financial statements every business owner should understand – the balance sheet, income statement and cash flow statement:

### 1. Balance sheet

The balance sheet is a snapshot of your business' financial position at a specific time. It shows what your company owns, what it owes and the owner's investment.

By analyzing the balance sheet, you can assess your business' liquidity (ability to meet short-term obligations), solvency (ability to meet long-term commitments) and overall financial strength. For example, a high level of cash and accounts receivable relative to accounts payable may indicate good liquidity and a high level of equity relative to liabilities may indicate good solvency.

Remember, the balance sheet is a snapshot in time. It can change rapidly as your business operates, so it's important to review it regularly to stay informed about your financial position. There are three parts to the balance sheet:

- Assets: The resources your business owns that have value, such as cash, accounts receivable, inventory, equipment and real estate.
- Liabilities: The debts or obligations your business owes to others, such as loans, accounts payable and accrued expenses.
- Equity: This represents the owner's claim to the business' assets. It's the owner's investment after deducting liabilities.

### 2. Income statement

The income statement tells the story of your company's profitability over a particular period. It tracks your revenue (the money you make) and expenses (the money you spend), revealing your bottom line: your net income or loss.

The income statement provides valuable insights into your business' profitability and costs. It helps you identify areas where you can increase revenue, reduce expenses and improve your overall financial performance. For example, if your operating expenses are too high, you may need to streamline operations or cut unnecessary costs.

It's a powerful tool for tracking your financial progress over time. By comparing statements from different periods, you can begin to identify trends and adjust your business strategy as needed. There are many components to an income statement, including:

- Revenue: The total amount your business earns from the sales of goods or services before expenses are deducted. It represents your total income.
- Cost of goods sold (COGS): These are the costs associated with producing or delivering the goods or services you sell, including raw materials and labor.
- Gross profit: This is calculated by subtracting COGS from revenue. It represents the profit your business makes after accounting for production costs.
- Operating expenses: These are the costs of running your business that are not tied to production, such as rent, marketing, salaries and utilities.
- Operating income: This is the profit generated from your core business operations; you can calculate it by subtracting operating expenses from gross profit.
- Other income and expenses: This category includes income or expenses not directly related to your core business operations, such as investment gains or losses, or one-time expenses.
- Net income: This subtracts all the expenses, including taxes, from the total revenue. Net income is the profit your business makes after accounting for costs.

### 3. Cash flow statement

The cash flow statement highlights the actual movement of cash in and out of your company, making it an important financial document. It tracks the sources and uses of your cash, providing a clear picture of your liquidity – your ability to pay bills, invest in growth and overcome financial challenges.

Cash flow is essentially the lifeblood of your business. Even a profitable company can struggle to survive without a healthy cash flow. That's why it's crucial to understand the different types of cash flow and how they impact your business' financial health.

Understanding your cash flow can help you ensure you have enough cash to pay bills, meet payroll and cover unexpected expenses. It may also let you plan for growth, investing in new products, marketing or opportunities. Finally, it can help spot potential red flags. Negative cash flow can signal many possible problems, and identifying them early can help you take action.

Regularly reviewing your cash flow statement can help you better equip yourself to make decisions that lead to business growth, profitability and long-term success. Here are the key components of the cash flow statement:

- Operating activities: Tracks the cash flow from your core business operations, including cash from customers, paid to suppliers, employee salaries and other operating expenses.
- Investing activities: Tracks the cash flow related to your investments in assets, such as a purchase or sale of equipment, real estate or other long-term investments.
- Financing activities: Tracks the cash flow related to financing your business, including borrowing or repaying loans, issuing stock and paying dividends.

## Implement tax management strategies

Taxes are an inevitable part of doing business, but they don't have to be a burden. Understanding the tax landscape and implementing smart strategies can help minimize tax liabilities, maximize deductions and keep more of your hard-earned money in your pocket. The IRS has [several tools and resources](#) to help you understand small business taxes. That said, IRS rules can be complex. Therefore, it is strongly recommended to consult a qualified, certified professional accountant (CPA). It is also recommended to find a CPA who works regularly with business entities. A CPA can review your current financial profile and should be able to suggest helpful tax strategies. Accountants can also file your business tax returns for you, which could save you a lot of time and effort.

The most common taxes for small businesses include:

- Income tax: This is a tax on your business' profits. The amount you owe depends on your business structure (sole proprietorship, partnership, LLC or corporation) and your income level.
- Self-employment tax: If you're a sole proprietor or partner, you may also owe self-employment tax, which covers Social Security and Medicare.
- Sales tax: If you sell goods or taxable services, you may likely need to collect and remit sales tax to your state and local government.
- Payroll tax: If you have employees, you may be responsible for payroll taxes, which include Social Security, Medicare and federal unemployment taxes.
- Property tax: If you own business property, you may owe property taxes to your local government.

### Claim tax deductions

Certain business expenses can be deducted on your company's tax return, which may help lower your company's overall tax bill.

Included in the types of expenses the IRS allows businesses to [deduct](#) as of today are:

- Advertising and marketing: Costs for advertising, website development and promotional materials.
- Business use of home: If you use part of your home for business, you may be able to deduct a portion of your rent or mortgage interest, utilities and home insurance.
- Business use of car: You can deduct mileage or actual expenses for using your car for business purposes.
- Depreciation: You can deduct the cost of depreciable assets, such as equipment and vehicles, amortized over their useful life.
- Employee benefits: Costs associated with the provision of employee health insurance, administration of retirement plans among others.
- Interest: Interest paid on business loans and business credit cards.
- Legal and professional fees: Attorneys' fees, an accountant's fee and fees of other select professionals who have advised on relevant business matters.
- Office expenses: Costs for office supplies, business software and subscriptions.
- Rent or lease payments: Payments for office space or relevant equipment leases.
- Travel: Many costs associated with business travel including airfare, hotels and meals.

It is very important to note that because every business is different, certain deductions, including those cited above, may or may not apply or relate to your company's unique situation. Furthermore, certain expenses that may otherwise be deductible might be subject to limits or other carve-outs. Finally, tax laws, including permissible business expense deductions, can change from year to year. Only a qualified tax professional, particularly one who works with businesses, can definitively advise.

### Consider investments

[Small business owners](#) have unique potential opportunities available to them that can help grow wealth. Making smart financial choices can help fuel your business' growth and ensure long-term sustainability. Sound investment planning can be a key aspect to help them achieve their financial goals.

When choosing investments, always consider your risk tolerance. Some investors are comfortable with higher-risk, higher-return options, while others prefer to invest in lower risk, potentially more stable solutions. A diversified portfolio that aligns with your risk profile can help you weather market fluctuations. Reinvesting profits into your business can be fundamental to growth, but there are other potential ways to diversify your investments and overall portfolio, including:

- Leveraging business assets: If you own commercial real estate or valuable equipment, you may be able to use them as collateral to secure loans for expansion or other business purposes.
- Upgrades to inventory: Investing in additional inventory can help meet increased demand, and upgrading equipment might help maximize your team's efficiency.
- Stock market opportunities: As a business owner, you may want to consider investing in stocks, bonds, mutual funds and publicly-traded real estate investment trusts (REITs). While there are always risks to investing, particularly on publicly-traded exchanges, diversification may help reduce your exposure.

As with taxes, it is always a good idea to consult a qualified investment professional. Doing so could be a good investment in and of itself.

### Start preparing for your business' financial future

Becoming comfortable with essential financial concepts, you will be better-equipped to make informed decisions, optimize your company's finances and help ensure long-term financial health.

Find more tips for growing your small business with [Verizon small business free online resources](#).

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