

# The Business Owner<sup>®</sup>

## Business Owner and Real Estate: A Winning Combination

Real estate is an outstanding investment. Let's count the ways:

1. **Durable Value:** Unlike businesses, where value may swing wildly with the ebb and flow of profits, real estate has value aside from the cash flow it generates. Businesses almost always are valued on their profits. Real estate almost always is valued on the comparable sales method. That is, what do other properties of this type go for per square foot?



Another example of durable value is that, with a business, if something bad happens, the value may go down to zero. Take a restaurant: Serve some really bad food for just a day or two, and the business may be ruined. In contrast, improvements to real property can burn down and the land still has substantial value. It doesn't go to zero.

2. **High Loan-to-Value Ratio:** There are two types of value in any asset — tangible and intangible. Tangible value is far less volatile and risky. Banks will lend up to 80% on tangible value. Why? Because it's safe. Not so for intangible value, which is the difference between total value of your business and tangible value of underlying assets. Real estate is 100% tangible value. Banks will lend more against real estate than almost any other asset.
3. **Liquidity:** Now don't get me wrong. Real estate is an illiquid asset. But compared to a business, it almost could be considered liquid. Many more people are comfortable buying and owning real estate. And real estate sells more quickly than a business.
4. **Low Relative Transaction Cost:** Buying and selling real estate is relatively inexpensive. Owning it can be expensive, but marketing property for sale is quite easy and inexpensive.

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THE BUSINESS OWNER **1977-2007** CELEBRATES 30 YEARS

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# From the Editor

Is anyone getting tired of me harping about diversification? Yes, I realize that it's hard as heck, especially when profits aren't necessarily plenty. But it is so darn important.

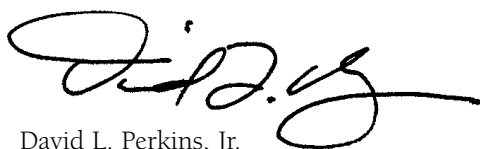
Concentration of all your financial well-being in a single investment is as risky as it gets. And I'll say it again — the low-hanging fruit is the funding of retirement accounts and the building of equity in your home. In the case of retirement funds, the government lets you fund these with pretax dollars. And if the worst-case scenario lands on your doorstep, nobody can take your retirement dollars away. Ditto for your home, assuming you haven't pledged it as collateral for a loan you become unable to repay.

Okay, enough already on the diversification issue. So allow me to get back on my soapbox regarding minority ownership issues! Please read "Protect Yourself When Gifting, Selling or Transferring Ownership." I promise — you don't want to get caught unprotected in this area. Does anyone agree with me?

On the lighter side, how about the strength of the current economy? God bless America. So many businesses that we talk to are hitting record revenue and profit. So many are making huge strides toward building the company they've worked so hard to create. Dreams are coming true. All that labor is bearing fruit. Great work to each and every one of you. Keep it up, but be cautious in the way you spend your profits. No doubt, tough times will return. Make sure you have enough capital to weather the tough times, and that you can use the slow times to retool and make the most of the eventual recovery.

Please email me with your comments, experiences and suggestions. [David@TheBusinessOwner.com](mailto:David@TheBusinessOwner.com).

Sincerely,



David L. Perkins, Jr.  
Publisher and Editor



David L. Perkins, Jr.

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**REAL ESTATE**

# Pricing Real Estate to “Buy Right”

As with any asset, real estate is valued in three ways: asset method, market method and income method.

**Market Method:** Often referred to as comparable sales method. The question of “fair price” on any piece of real estate is answered by simply determining what similar properties have recently sold for. Real estate brokers can pull comparable sales data for you. The prices may be more art than science because no two pieces of real estate are exactly alike.

**Income Method:** This method works only for income-generating real estate. The question of “fair price” is answered by determining income generated by the business and then applying a fair rate of return. Following is a table of rates of return on various investments over the past 90 years. Buyers of investment real estate generally require anywhere from 8% to 16% return on investment. If the projected cash flow is estimated to be steady or steadily growing, then a very simple formula can be used to determine value. For example, if the property is projected to generate \$100,000 per year in net income, and the buyer thinks a 13% rate of return is fair (given the overall characteristics of the property), then the value is \$769,230.77, calculated as follows:

$$\frac{\$100,000}{0.13} = \$769,230.77$$

*Note: The type of income or cash flow used in investment real estate is net operating income (NOI).*

*Net operating income (NOI) is projected for income-producing property after deducting all operating expenses, including taxes and a factor for expected periodic vacancy and collection losses.*

*Note: Debt service is paid outside of NOI.*

**Asset Method:** This method is often referred to as the replacement cost method, and is used primarily for owner-occupied real estate. The prospective purchaser asks, “How much would it cost me to build a building similar to this?” He then compares this to a building he is thinking of buying. The rational buyer would purchase an existing building if it could be done at a lower cost than building something new, but would still need to consider issues such as location, condition, maintenance costs, utility costs, remaining useful life, etc.

Which method should you use? Smart buyers use them all. When looking at a piece of property, they run the numbers using all three methods and consider the insight gained from each. They use the resulting information to assess what they think is smart for themselves, and also to negotiate strategically with the seller. □

**“If A equals success, then the formula is A equals X plus Y and Z, with X being work, Y play, and Z keeping your mouth shut.”**

*Albert Einstein*

## 9 Essentials to Successfully Diversify into Real Estate

To reduce risk, every business owner should strive to diversify his or her assets and investments. Real estate has compelling characteristics and is a must-have in every business owner's portfolio. Here are tips for making the most of your move into real estate.

1. **There's No Place Like Home:** Everyone's #1 goal should be to own his or her own home and pay down debt so they'll have a substantial amount of equity. Philosophies differ on whether a completely paid-off home makes financial sense, but I'd argue that full payoff is a prudent goal for the business owner. Why? First, most business owners have debt against their business. Assuming the business is organized as a pass-through entity (basically, any legal entity type besides a C-corporation), you're getting an interest expense deduction — just as you would get for interest on home mortgage debt. Second, private business is a risky thing. You never know how the competitive or economic landscape could change in the future. Offsetting this risk with a paid-up home provides substantial comfort. Couple this with the fact that, legally, nobody can take your home away from you as long as you haven't pledged it as collateral for a loan. So, if you own your home outright, you could suffer total financial catastrophe and still keep your house. Let's never underestimate the comfort in that.
2. **Occupy Your Own Real Estate:** If your business rents real estate and you have substantial equity in your home, it makes sense to set a goal of owning the property that your business occupies. In simple terms, if you are going to pay rent, why not pay it to yourself? If your business is site-specific, such as a restaurant, this might be tough to accomplish but not impossible. The only answer is to negotiate hard, be persistent, and use whatever leverage you have as a good tenant. If you can't get an outright purchase, go for an option and/or a lease-to-own agreement. If your business is not site-specific, you have the freedom to relocate. Find a great deal and make a move. It'll be a chore but will surely pay dividends over time.
3. **Set Clear Parameters:** You know your usage needs. You also know your financial capabilities. Find a trusted real estate investor or broker and discuss your desires. Lay out details about the specific property that make sense for you. What geographic areas make sense? What characteristics must the site have? Do you want to be the sole occupant or lease to others? How many others? How much equity can you contribute? How much debt service can you and/or your business handle? Do you want a fixer-upper?
4. **Location, Location, Location.** Municipalities have substantial influence on the path of future development — primarily in their ability to locate new roads and highways, expand and improve roads and intersections, locate schools, build bridges, etc. In your efforts to buy real estate in an "up and coming" area, find out what is planned in your community. Determine what organizations do your city and county planning. Go talk to them. Ask them where the growth is now and what capital projects can be expected to take place in the future.

5. **Deal Flow:** The key to finding a good deal is finding lots of deals. Once you set your purchase parameters, get the word out. Tell every person and broker you know. Be willing to pay full commission. You might even consider hiring an exclusive broker-representative. Give them your parameters and tell them you want a good deal.

6. **Don't Overpay:** With real estate, timing is everything. Another way to say it is: Patience pays. Your goal should be to find a really good deal. What's a good deal? You want to pay less than prevailing comparable sales in your area. Good deals are available. Always keep in mind that your desire for a good deal is not just a matter of greed or luxury; it's a matter of caution. Take your analysis with a grain of salt and a bit of humility. You could be a little off on your analysis — in the wrong direction. You or the property could suffer an unforeseen event. For all these reasons, you need a cushion. Buy right or don't buy at all.

7. **Due Diligence:** As with most things, what you see may not be what you get. Before you buy, make sure you know what you're getting. Never agree to purchase before you are totally satisfied with conditions. Environmental issues are #1. NEVER buy a piece of property without thoroughly checking environmental conditions. Hire an expert to do a Phase I environmental review. If the auditor finds cause for concern, have the seller pay for a Phase II review. If he won't, walk away. And remember that commercial property is just like a house. Get an expert to check the structural, electrical, plumbing, etc. Fixer-uppers might offer the best opportunity for value appreciation, but be sure the only needs are cosmetic.

8. **Financing:** Rule #1 is to make sure your risk of default is low. Don't buy if you don't have the financial wherewithal to withstand some bad luck, such as long-term vacancies. Rule #2 is to shop around. As with your home, you'll find many financing options when you buy commercial real estate. Study them carefully — assessing costs as well as appropriate amortization schedules. A quicker pay-down will reduce interest expense and build equity more rapidly, but you don't want to risk default.

9. **Own It Outside of Your Business:** Don't purchase your real estate through your business. You'll lose much of the diversification benefit, because if your business fails, the real estate will go down with it. Buy it personally or through a separate legal entity. When the time comes to retire and/or sell your business, you'll be set to rent your real property to the new owner. Can you say, "Passive income?" It's a beautiful thing.

Real estate is an incredible thing to own. It has tremendous attributes, many of which beautifully complement ownership in a business. Of course, every investor should be leery of financial

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**Real estate has compelling characteristics and is a must-have in every business owner's portfolio.**

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# Exchanging Equity for Income: The Reverse Mortgage

A reverse mortgage is a special type of loan used by older Americans to convert the equity in their homes into cash. The reverse mortgage is aptly named because the payment stream is reversed. Instead of the borrower making monthly payments to a lender as with a regular first mortgage or home equity loan, a lender makes payments to the borrower. Just as with a regular mortgage, ownership of the home remains with the borrower.

The money from a reverse mortgage can be used for ANYTHING from daily living expenses, home repairs and home improvements, medical bills and prescription drugs, to pay-off existing debts, education, travel, long-term health care, prevention of foreclosure, and other needs. In fact, proceeds from a reverse mortgage may be used to pay off an existing mortgage. If your home needs improvements to qualify for a reverse mortgage, a portion of the proceeds may be set aside for this purpose.

A reverse mortgage need not be repaid until the borrower no longer lives in the home. The lender will recover its principal and interest when the home is sold. The remaining value of the home will go to the homeowner or to his survivors. If the sales proceeds of the home are insufficient to repay the amount owed to the lender, HUD will pay to the lender the amount of the shortfall.

Proceeds from a reverse mortgage may be received in several ways: all at once (lump sum), fixed monthly payments (for up to life), a line of credit, or a combination of a line of credit and monthly payments. The most popular option, chosen by more than 60 percent of borrowers, is the line of credit, which allows you to draw on the loan proceeds at any time.

To qualify for a reverse mortgage the homeowner must be at least 62 years of age. There are no income or medical requirements and the house does not need to be debt-free to qualify for a reverse mortgage.

## Quick Take

- Used to convert equity in a home into an income stream
- Must be 62 years of age or older
- Ownership of the home remains with the borrower/homeowner
- Money can be used for anything
- Need not be repaid until the borrower no longer lives in the home
- Lender will recover its principal and interest when the home is sold. If the home sells for more than is owed, the excess goes to the homeowner or his or her heirs. If sale proceeds are insufficient to repay the amount owed, HUD will pay to the lender the amount of the shortfall.
- Money provided to you from a reverse mortgage is tax-free.
- Offered by banks, thrifts and other financial institutions.

The size of the reverse mortgage that you can get will depend on your age at the time you apply for the loan, the type of reverse mortgage you choose, the value of your home, current interest rates, and, sometimes, where you live. In general, the older you are and the more valuable your home (and the less you owe on your home), the larger the reverse mortgage can be.

The costs associated with getting a reverse mortgage include the origination fee (which usually can be financed as part of the mortgage), an appraisal fee and other charges similar to those for regular mortgages. The money provided to you from a reverse mortgage is tax-free. But the funds received from a reverse mortgage may affect the borrower's eligibility for certain kinds of government assistance, so you should check into this before getting a reverse mortgage.

Be assured that the lender cannot take away your home if you outlive the loan. In other words, the loan does not become due until your home is sold, is no longer your primary residence or you die. You cannot be forced to sell your home to pay off the

mortgage loan even if the loan balance grows to exceed the value of your property.

To apply, you must first meet with a reverse mortgage counselor. You can obtain a list of the reverse mortgage counseling agencies by calling HUD at 1-888-466-3487 or accessing HUD's Web site at [www.hud.gov](http://www.hud.gov).

Reverse mortgages are offered by banks, thrifts and other financial institutions. Currently, four reverse mortgage products are available to U.S. consumers and one product is available in Canada. In the U.S., the most popular reverse mortgage is the federally insured reverse mortgage, called the FHA Home Equity Conversion Mortgage Program (HECM). The other major product is the Home Keeper reverse mortgage, which was developed in the mid-90s by Fannie Mae, a private national mortgage company.

If you or a loved one has modest income but a large amount of equity in a home, consider the reverse mortgage as a low-risk way to obtain income while retaining control of your homestead. See your financial advisor or a reverse mortgage counselor for more details. Proceeds from a reverse mortgage can even be used as capital for a business.

Be aware that scam artists charge thousands of dollars for information about reverse mortgages. This information is FREE from Housing and Urban Development (HUD). And HUD does not recommend using an estate planning service or any service that charges a fee for referring a borrower to a lender. □

## 9 Essentials to Successfully Diversify into Real Estate, continued from previous page

risk — risk that results from debt levels that could become difficult to maintain. So don't expand into real estate imprudently. But when times are good and your company is generating excess cash flow (or holding extra cash or low levels of debt), consider adding more real estate to your personal portfolio. Long-term odds are it'll pay big dividends. □

**Business Owners and Real Estate: A Winning Combination,**  
continued from cover

5. **Consistent Appreciation:** Over the long term, real estate has proven to be one of the most reliable types of investments. As long as you don't overpay and are careful to buy in desirable areas, it is almost impossible to lose money in the long run on real estate.
6. **Low Employee Count:** Owning real estate does require some work, but compared to a business, it's a piece of cake. And one of the most difficult, expensive and time-consuming elements of business ownership is labor. You may not have to hire a single person to manage your real estate investment. Now **that** is beautiful.
7. **Tax Advantage:** Hold real estate for more than a year and, when you sell, you'll enjoy long-term capital gains tax rates. This is the same as most other investments, but couple this with the fact that, if the real estate you purchase has improvements (i.e., is not raw land), you will be able to depreciate over time the value of the improvements. This will shelter income from tax as you own the property. When you purchase stocks or bonds, this is not possible.
8. **Source of Capital:** Over time, as you own real estate, you will no doubt pay down the debt you used to purchase it with. Couple this with likely appreciation in value and you build equity. This equity can become a valuable source of capital when times get tough or you need cash to take advantage of an investment opportunity. As we said above, banks stand ready and willing to lend on real estate. It's something they do every day and are very comfortable with.

Most business owners suffer from a lack of diversification. So most of their wealth is tied up in their business. Real estate is highly recommended as a first step toward diversification. Probably retirement account contributions should come first, but real estate is a very close second. First your home, then the space your business occupies. □

**Upcoming Features in  
The Business Owner Journal**

**May/June 2007 Issue**

David vs. Goliath — How to Compete Against the Big Boys

**July/August 2007 Issue**

Defined Benefit Plans and Deferred Compensation Plans

**September/October 2007 Issue**

Building Value

**November/December 2007 Issue**

Employee Handbooks

**January/February 2008 Issue**

Insurance and the Private Business Owner

The content and dates herein are tentative and subject to change at any time.

**Mail Bag**



*I am an HR Manager and my CEO just received a copy of your publication. It had some good information in it and on the whole I enjoyed reading it. However, I completely disagree with one of the items in the "9 Tips to Make the Most of Your Holiday Party" article.*

*It is a Christmas Party if you are having it for Christmas. It's not a Holiday Party. It is ridiculous that we have to be so sensitive of others to the point we ignore what the holiday really means and why we are celebrating it.*

*Sincerely,  
Chyrel*

**Reply from the Editor:**

No doubt, many feel the way you do. I also feel that way at times. But I take solace in a few things. First, nobody can tell you or me what the season means to us. No matter how the world celebrates it, you and I have complete freedom to hold in our heart whatever we choose. Second, I want everyone to feel comfortable and welcome at my holiday party. That includes people of all beliefs and backgrounds. Diversity is one of the things that makes the world an incredibly interesting place. I say, "Call it a holiday party and come one, come all, and bring whatever it means to you and let's celebrate and share and get to know one another better." Finally, being sensitive to others is never out of place. After all, Christianity started with a man who preached inclusion. □

**"Any fool can buy a company. You should be congratulated when you sell."**

*Henry Kravis, partner, Kohlberg, Kravis, Roberts*

**Ask the Editor:  
Can We Have a 401(k)  
and an ESOP?**

**Question:** In your November-December 2006 issue you said an ESOP is a "defined contribution retirement plan." If this is so, can a company that has a 401(k) plan also do an ESOP?  
*Jerry Shirley  
National Graphic Supply*

**Answer:** Yes, a company that has a 401(k) plan also can have an ESOP. All that is required is for the company to adopt an ESOP component. This is done by simply amending the 401(k) plan document to include an ESOP profit-sharing feature. Total contributions per participant for both plans are limited to \$45,000 (or \$50,000 with a catch-up contribution). Plans having non-leveraged ESOP arrangements can experience positive cash flow benefits, because ESOP stock rather than cash can be used to make the employer retirement contribution. □

# What Does Your “Phone Door” Look Like?

“People enter your business through two doors,” says Brett Bond, owner of Sound Advice. “Your front door and your phone door.”

**Business owners don't often enter through their company's phone door, so it may be in disarray and you don't even know it.**

The impression at each must be your very best. Today, for many businesses, more people pass through the “phone door” than the “front door.” Business owners don't often enter through their company's phone door, so it may be in disarray and you don't even know it.

In addition to first impressions, there's also an opportunity — each time someone calls — to strengthen your company's brand image and educate the caller on your products, services and strengths.

What does your phone door look like? What is the harsh reality of your customers' experience as they enter your company through your phone door? Are you taking full advantage of the opportunity with every single call? Here are some simple ways to make a big difference.

**Secret Shopper:** Do you really know what your phone personnel are saying every day to your customers? Why not have someone call your office — your salesman, or your tech support person — and pose as a customer or prospect. Record the entire experience. Large companies do this all the time. We did it at *The Business Owner* and found it VERY revealing and humbling. Afterward, we made some changes.

We used FoneFacts ([www.FoneFacts.com](http://www.FoneFacts.com)). FoneFacts provides one — and only one — service specialty: telephone surveying. By posing as your customers, they professionally extract the “facts,” audit and recap the information you need to know. We simply called FoneFacts, told them what we do, explained the types of customers who call us, gave them our main phone number and suggested what to say. It was easy. Their customized software and recording technology allow them to provide you with any type of detailed reporting on key performance factors. I'd suggest that you set them up to test your phone door regularly.

Here's just some of what FoneFacts can do for you:

**Employee Evaluation:** Maximizing your employee's telephone skills as they relate to your sales and/or customer service goals is an ongoing process of training and evaluation. FoneFacts specializes in recording, scoring and reporting your company's telephony skills.

**Competitor Analysis:** If you have ever wondered about the sales ability and customer management skills of your competitors, FoneFacts can provide you with a detailed look at what others say and do. You will find that the competitive analysis goes well beyond product comparisons.

**Market Research:** Determining market awareness, opinions or knowledge of

your product and/or service is often difficult. FoneFacts can call, record and report your market share.

**Customer Surveys:** Do you really know what your existing or past customers say about your product and/or service? FoneFacts will provide you with easy-to-evaluate facts that often surprise management.

**General Analysis:** For any other analysis your company might need that can be extracted by the telephone, FoneFacts helps you get the facts.

**On-Hold Messaging:** If you don't use your on-hold time to sell, cross-promote other products and services, and drive traffic to your Web site — get with it. It's easy, effective and economical. We used Brett Bond of Sound Advice ([www.4SoundAdvice.com](http://www.4SoundAdvice.com)). He is tremendous. Sound Advice charges a minimal monthly fee based on the number of times you want to update the content playing on hold. With professional voice talents and varied music selections, Sound Advice puts together messages that reflect the image and information your customers need to know. No matter where you live, Sound Advice can upload new messages directly to your phones with the push of a button.

**Virtual PBX:** Are you ready to delve into new technologies to save big bucks and improve the way your system works? So-called virtual PBX appears to offer compelling services and substantial value. Using a single toll-free or local number and a virtual PBX such as GotVMail ([www.gotvmail.com](http://www.gotvmail.com)), you can get an auto attendant, call routing, voice mail, on-hold messaging, etc., all with no more hardware than a regular phone. In addition, you can have the service “find you” when a call comes in, such as by ringing your office twice, then your cell phone — all while the caller hears testimonials and/or service offerings (i.e., a custom on-hold message).

You also can have voice mail messages immediately e-mailed to you in text or audio file form. In addition to GotVMail.com, check out [onebox.com](http://onebox.com) and [virtualpbx.com](http://virtualpbx.com). Costs start at less than \$10 per month.

**There's an opportunity — each time someone calls — to strengthen your company's brand image and educate the caller on your products, services and strengths.**

Phones are critical to your business. If you don't think so, just try unplugging it for a day, or even an hour. You've invested in your phones — so use them to their fullest potential. The great news is that today, with technology, you should be able to deliver a topnotch first impression and flawless service for very little cost. The trick is figuring out how to do it. The only solution is to either delegate the job to someone you trust or do it yourself. Either way, get it done. It's just too important. □

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# These Things Could Shut You Down Fast

What could shut your business down fast?

Business owners face a myriad of risks. Prudence calls upon us to continually reduce our exposure to random events. When I was a banker — lending to businesses — I used to ask my clients, “What could shut your business down fast?” I’d make a list and discuss it with the owner. I wanted his or her opinion on the likelihood and potential impact of each threat, and what — if anything — had been done to mitigate risk. If the business remained exposed to real threats, I would ask the owner to address the issue before I’d agree to make the loan.

**Risk Matrix.** Marshall and Alexander use a tool for assessing risk in their *Journal of Extension*. Here is a summary:

**Step 1:** List and Rate the Threats to Your Business.

What risks does your business face? List them in Table 1 below. We added examples to get you started.

For each risk, estimate probability and consequence. Use a 1-to-10 scale for each (1 being the lowest). The consequence of the event can be thought of both in terms of severity and cost to the business. For example, in our sample event #1, the owner is in a car accident that prevents him from fulfilling his normal duties for a period of six weeks. We rate the probability a 3, with the consequence of the owner being unable to fulfill his duties for six weeks rated at 8.

**Step 2:** Plot Each Event on a Matrix.

Draw your own matrix on a piece of paper, identical to Figure 1 below. Then, plot each risk as you have rated it. We’ve plotted our sample events on this one.

**Step 3:** Devise a Response and Plot Movement

There are four basic risk management strategies. Here’s a summary:

- **Avoid Risk** — The business takes action to avoid anything that might give rise to the risk. Typically this means the business chooses not to undertake an activity. For example, a farmer may decide not to grow lavender because the growing conditions are unsuitable, probability of a crop failure is elevated and the consequence of a loss would be severe. This is represented in our example as event 6.

**Table 1:** What Risks Does Your Business Face?

On a scale of 1-10 (1=low), rate the probability and consequence (severity, cost) of each event

Event	Probability	Consequence
1. Server crashes, database lost	3	10
2. Owner, 80, passes away*	8	8
3. Owner, 35, passes away*	1	10
4. Stacy Shirley quits or becomes unable to work*	4	9
5. Owner becomes unable to work for a while*	3	6
6. Loss of our lavender crop*	3	9

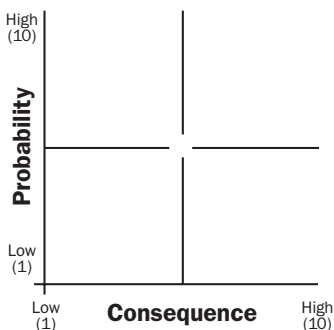
\* hypothetical examples

As you’ll see below, we have crossed out 6 because we decided to deal with the event by avoiding it.

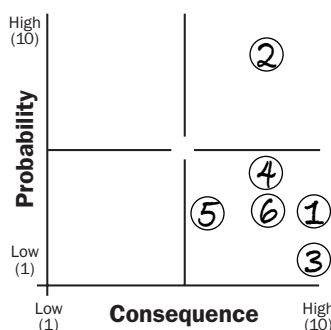
- **Reduce Risk** — The business takes action to reduce either the probability or consequence of the risk. In table1, event 4, we have substantial exposure in losing Stacy Shirley, who is our #1 sales rep. She accounts for 75% of our business and we feel that the customer’s loyalty is with her more than with us. This risk management matrix exercise has made us realize the level of this exposure, and we believe it is unacceptable. To deal with it, we will attempt to work on a long-term contract with her that will bind her to us, with penalties for breach. We also immediately will begin a program to: (a) build relationships directly with “her” customers and (b) boost the percentage of customers that we obtain through means other than Stacy Shirley. We have marked our strategy on the chart below by drawing an arrow from 4, down and to the left. This signifies that we are working to lower both the probability and consequence of her loss.
- **Retain Risk** — This is a do-nothing response, or at least a “suffer the consequences when they come” response. Unanticipated events will occur, and they all can’t be eliminated no matter how thorough the planning. But something almost always can be done. For example, in event 5, we can train others to do the key tasks regularly

*continued on next page*

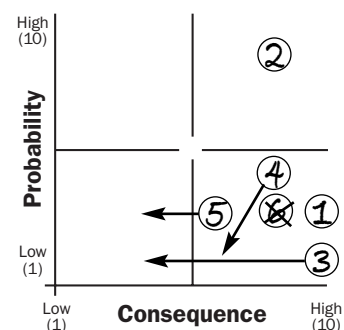
**Figure 1:** Blank Risk Management Matrix



**Figure 2:** Risk Management Matrix with Events Plotted



**Figure 3:** Risk Management Matrix with Events Plotted and Strategies Marked



**These Things Could Shut You Down Fast, continued from previous page**

performed by the owner. Or find others who could do some of the key tasks on an outsource basis. For “testing,” we could have these persons actually perform the key tasks for a month. For example, the business owner could take an extended vacation. To designate our plan for reducing the consequence of our owner being “unable to work for a while,” we have drawn a horizontal arrow pointing left. We have not reduced the probability, but if we do as planned, we will reduce the consequence. See Figure 3.

- **Transfer Risk** — This is moving the risk to someone else, such as an insurance company. Insurance is the most common method of dealing with the potential loss from random events. So example event 3 is readymade for life insurance. The insurance should be fairly cheap, assuming she is healthy. If the event occurs, the business might not be able to continue on, but the policy proceeds can mitigate

the financial harm inflicted on the creditors and family of the owner. We’ve marked our strategy in Figure 3 with an arrow pointing down. We have not reduced the probability, but with insurance we’ve reduced the consequence.

You’ll notice that example events 1 and 2 still need to be addressed.

To be sure, every business owner should periodically ask himself or herself and employees and advisors, “What could shut us down the fastest?” Then take action to mitigate risks. You’ve put a lot of work into this business, and a lot of people now depend on you for their livelihood. Your job is to protect them and the business. □

### References

Marshall, M. I., & Alexander, C. (2006). *Using a Contingency Plan to Combat Human Resource Risk.* *Journal of Extension (online)*, 44(2) Article 2IAW 1.

## STRATEGY

# Put All Your Eggs in This Basket: Customer Satisfaction

When customers are asked what is important in a business relationship, they commonly reply: price, quality and on-time delivery. But today, everybody has on-time delivery. And price may not be the holy grail because rarely does the lowest bidder get the job.

In *Managing Customer Value*, Bradley Gail describes the “Customer Value Proposition” as the ability to supply a perceived product value that is higher than the actual product cost. But evidence is everywhere that customer value does not necessarily lead to high customer loyalty and resulting success.

For example, Splenda is generally judged to be a superior match to sugar when compared to Sweet’N Low, the early market entrant. But Splenda has stagnated in its quest to win over Sweet’N Low users, despite what many believe to be an inferior product.

Similarly, Coke continues to outsell Pepsi in spite of consistent preferences for Pepsi in blind taste tests. Wegmans, a regional grocery chain based in Rochester, N.Y. outsells its national competitors nearly two to one. It somehow does this while selling largely the same products.

The common thread among these enormously successful companies is unbending customer loyalty. Totally satisfied customers are up to 10 times more likely to repurchase than customers who are only just satisfied. Totally satisfied customers don’t even entertain competitive offerings. “Businesses with the best growth rates and long-term stability have high percentages of repeat customers.

### Quick Take

What differentiates successful companies from those that struggle? One thing is customer satisfaction. When customers are highly satisfied, they remain loyal. They return again and again and don’t ask for a better price. And therein you find growth and profit.

This applies to a wide range of businesses and industries, including commodity businesses with thin profit margins.”<sup>1</sup>

In addition, highly loyal or satisfied customers are more receptive to cross-selling. An article in *The Journal of Service Research* states: “The relationship between satisfaction and actual share-of-wallet in a business-to-business environment is not

only positive, it is nonlinear, with the greatest positive impact occurring at the upper extreme of satisfaction levels.” This is further supported by research conducted by IBM that found a ratio of revenue growth between very satisfied and satisfied customers of 3:1.<sup>2</sup>

It appears that companies must not only provide quality goods and services but also the highest levels of performance in areas that affect total customer satisfaction. Measuring performance in these terms is vitally important.

Also see the accompanying article on page 11, “Tips for Measuring Customer Satisfaction.” □

*Morris Binder provided his expertise for this article. He is president of BLC-Bottom Line Connection-Corporate Division, a Baltimore-based sales, market development and market research firm. You can reach him at mbinder@hireblc.com.*

<sup>1</sup> “Why Satisfied Customers Defect,” Jones, Thomas O.; Sasser Jr., W., *Harvard Business Review*, Nov/Dec. 95, Vol. 73, Issue 6

<sup>2</sup> “The Quality Elephant,” Hoisington, Steve and Neumann, Earl, *American Society For Quality: Quality Progress*, February 2003

# Never Re-Enter Contacts into Your Cell Phone

Darn it! You finally get most of your phone numbers loaded into your cell phone and — you lose it! Don't let this happen again. Now you can back up all your data. Here's how.

## Solutions from Your Cell Carrier

Many cell carriers offer a backup service. Some allow cellular transmission of the data. Others require you to stop by one of their retail locations. Either way, the process is simple. Call (or stop by) your carrier and inquire. The fee tends to be \$2 to \$5 per month. We didn't call all carriers, but we confirmed that Cingular, Alltel, Sprint Nextel, T-Mobile and Verizon Wireless offer the service.

**Want to avoid the inevitable burden of having to re-enter your contacts into your phone? You have many options to choose from.**

Be aware that these services may not allow you to load your data into a phone that you get from a competing carrier. So, for example, if you upgrade from one Cingular phone to another — it

works fine. But if you want to switch from Cingular to Verizon, or vice-versa, the carrier services probably won't do you any good.

## Alternative Solutions

Because you'll periodically switch carriers, third-party backup options probably make more sense. Here are some software and hardware solutions that are getting good reviews online.

- **Backup Pal:** You don't need a computer with this hockey-puck-shaped little gadget. Plug the device right into your phone and it makes a copy of your phone list. The data stays on the gadget until you decide to load it into a phone. It comes with interchangeable adapters for compatibility with virtually any phone in the U.S. market. Cost is \$40 to \$50. An optional kit allows you to sync the data with a PC. PC sync add-on is an additional \$15. See [www.backup-pal.com](http://www.backup-pal.com).
- **CellStik:** This is the brand name for a little piece of hardware offered by Spark Technology ([Sparktech.com](http://Sparktech.com)). One end plugs into your phone where the battery charger plugs in. The other end plugs into a USB port on your computer. Built-in software allows you to save a copy of your phone list on your computer. You can then load the data into a phone when needed. Works with most Samsung, LG and Motorola phones. Cost is \$40.
- **USB Phonebook Flasher:** Yes, that's the name. Very similar to the CellStik (above). Cost is \$21. [www.usbgeek.com](http://www.usbgeek.com)
- **SIM Card Readers:** Several varieties of these are available and they all work basically the same way. You remove your SIM card (a tiny chip inside your phone, usually near the battery) from your phone, plug it into the reader device and do a backup. Some models available are:
  1. Universal USB SIM Card Reader and Writer. Cost is \$29. [www.suntekstore.com](http://www.suntekstore.com)
  2. SIM Card Reader by Dekart. Cost is \$33. [www.dekart.com](http://www.dekart.com)
  3. ZiO FoneMate SIM Card Manager and Reader. Cost is \$20. [www.smartdisk.com](http://www.smartdisk.com)

4. Clipper Gear SIM Saver Backup and Copy Unit. For GSM phones. Cost is \$20. [www.thetravelinsider.com](http://www.thetravelinsider.com).

- **Data Pilot Universal Pro Kit:** Comes with software and nine different connectors supporting Motorola, Nokia, LG, Samsung, Sony Ericsson and Sanyo. Syncs with Outlook and Palm desktop applications. Allows you to dial up to the Internet using your cell phone as a wireless modem, and accommodates MP3 and MIDI files, wallpapers, pictures, movies, etc. Cost is \$79.95. [www.susteen.com](http://www.susteen.com)
- **FutureDial Snapsync II:** Syncs your phone book and calendar data with PC software such as Outlook, Outlook Express or Lotus Notes. Cost is \$29 to \$35. Cables to connect your phone are extra and cost \$30. Additional software available to sync pictures and other multimedia costs \$19 to \$25. [www.futuredial.com](http://www.futuredial.com)
- **Bluetooth syncing:** If your phone and computer are both Bluetooth-capable, several software options are available for syncing wirelessly to your PC.
  - Motorola Mobile Phone Tools V4.0 is a good software-only option for Motorola phone users. Find it at [www.cellphonemall.net](http://www.cellphonemall.net). Cost is \$18.
  - Mobile Action Bluetooth Data Suite MA-730 is another all-software solution. It works on a wide range of phones. [www.mobileaction.com](http://www.mobileaction.com). Cost is \$30 to \$36 at [www.amazon.com](http://www.amazon.com).

Want to avoid the inevitable burden of having to re-enter your contacts into your phone? You have many options to choose from. Use the Internet to do a little research on options that will work specifically with your phone. Then git 'er done. □

## TECHNOLOGY

# Three Ways to Convert Business Taxes to Cash

Don't forget tax filings that can generate quick cash for your business or lower your future cash outflow.

- **Overpayment of taxes:** If you overpaid your 2006 estimated taxes, you don't have to wait until you actually file your tax return for a refund. Have your accountant file IRS Form 4466 to claim the refund.
- **Carry-back losses:** If you had a loss for 2006, you can carry back that loss against the taxes you paid the prior two years and get a refund. Use Form 1139.
- **Reduce estimated taxes:** You can defer payments of 2007 estimated taxes by filing Form 1138. This form is used when you anticipate a loss in your current tax year and expect to carry back that loss to a preceding year.

If any of these options apply to you, call your accountant to recalculate your company's tax bills for both 2006 and 2007. □

## About the Publisher



David L. Perkins, Jr. owns, writes, edits and publishes *The Business Owner*, the newsletter of choice for more than 35,000 paid

business-owner subscribers who are serious about building wealth through successful private business ownership.

Perkins draws editorial ideas and inspiration from his daily work as a merger and acquisitions consultant, where he has advised on more than 100 purchase/sale transactions involving both private and public companies. His M&A consulting firm is Vercor, which has 10 North American offices and a European affiliate. Vercor specializes in sell-side representation of businesses valued between \$5 million and \$50 million (see [www.VercorAdvisor.com](http://www.VercorAdvisor.com)).

Perkins holds a BA in psychology from the University of Oklahoma and an MBA from the University of Notre Dame. He has formal training in business valuation. He also pulls editorially from prior experience in commercial real estate leasing and brokerage, commercial bank lending and private company financial management.

Perkins is the author of *A Concise Overview of Business Valuation* and co-author of *The Business Sale, An Owner's Most Perilous Expedition*. You can buy both at [www.TheBusinessOwner.com](http://www.TheBusinessOwner.com).

Perkins is a professionally trained, content-rich platform speaker available for both keynote and breakout sessions. He is a Certified Toastmaster and a member of the National Speakers Association.

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# Tips for Measuring Customer Satisfaction

To achieve success, companies must generate repeat business, getting their customers to return again and again. And they do this by creating highly satisfied customers. But how?

Naturally, this rarely happens by chance. Rather, it's the owner's concerted effort to determine the issues that drive customer satisfaction — and then deliver on them. The only way to know whether you are delivering on them is to measure continuously.

**Troubling questions often emerge as internal or vested interests may inadvertently bias interpretations of customer comments.** Murray Corporation, a leading producer of hose clamps for automotive, appliance and other industries, based in Hunt Valley, Md., has been performing customer satisfaction surveys for several years, but it had no basis for comparative reference. Recently, using an outside marketing firm to design and conduct a candid survey, it found that its satisfaction scores as measured by the third party, though reasonably good, were substantially lower than the scores it recorded itself.

Such a scoring difference is typical, the result of both design and execution factors. But troubling questions often emerge as internal or vested interests may inadvertently bias analysis technique and subsequent narrative interpretations. Survey objectives also influence design. Companies often use surveys to develop and/or test their business strategies, ensuring that they are built on actual customer needs rather than perceived ones. Long-term business plans may be based on survey results, so the stakes could be quite high.

EIG Corporation, a refrigeration controls company formerly of Baltimore, was planning a complete revision to its business plan based on internally generated surveys and perceived customer input developed through its sales force. Again, the results of a professionally designed survey revealed that this strategy was a mistake, and identified previously unrecognized situations affecting customer satisfaction. It also found changes it was planning would exacerbate the problems.

Business owners often react to issues that are mere irritants, having little impact on satisfaction, while important issues hover beneath their radar. Survey development requires a clear understanding of objectives, methodology, objectivity and absence of bias. Companies conducting customer satisfaction research should strive to determine:

- What product and service issues are important to customers?
- How does the subject company perform on these issues?
- How do the issues impact future purchase intent?

The second step is to select a survey methodology, considering population size, geography and demographics. The format and feedback should:

- Accurately reveal status and performance
- Objectively understand the customer's perspective
- Provide actionable information for reaching total customer satisfaction
- Provide useful information on the marketplace and the competitive environment (benchmarking)

Certainly, survey design must effectively garner participation. Low response rates could render results meaningless, and business owners should be leery of acting on the results of a survey that received a low sample count. Customers who either love you or hate you usually dominate surveys that have low response rates. Neutral customers are less likely to respond. In short, a high response rate provides a higher comfort level because it represents a cross section of all customers. □

*Morris Binder provided his expertise for this article. He is president of BLC-Bottom Line Connection-Corporate Division, a Baltimore-based sales, market development and market research firm. You can reach him at [mbinder@hireblc.com](mailto:mbinder@hireblc.com).*

**Survey design must effectively garner participation. Low response rates could render results meaningless, and business owners should be leery of acting on the results of a survey that received a low sample count.**

# Protect Yourself When Gifting, Selling or Transferring Ownership

There are **many** circumstances when you may want to sell, transfer or give ownership:

- Giving stock to your children or spouse
- Granting stock options to key employees
- Entering into a buy-sell or stock purchase agreement
- Raising capital with warrants (option to buy stock) or a convertible security (right to convert debt or preferred stock into common stock)

You should take great care anytime you give, sell or transfer ownership interest in your business. As long as you want it to continue to be YOUR business — and you want the freedom to manage it as you see fit — be sure you retain control over who can become partners and/or co-owners. A bad partner/co-owner can be a very bad thing indeed. A minority owner doesn't control the company, but he or she can become a real irritant, or worse.

**This could happen to you:**

1. You give some stock to your daughter. She gets divorced and her ex-husband winds up owning part of your business. He demands regular financial reports and claims you are cheating on taxes.
- A. You give stock to an employee as an incentive to stay and grow with your company. After a few years, you have a falling out and you fire him. He goes to work for the competition and exerts his right to know what is going on at your company.
- B. Your son uses his stock as collateral for a loan. He defaults, and now the lender is your minority stockholder.

Smart business owners don't let these things happen. They use common mechanisms to establish control when giving or selling stock for **any** purpose — and to **any** person or firm. Of course, this applies to ownership interests you issue (from stock held by you) and any issued by the company (new issues or Treasury shares).

## Imperative #1: Restrict the Stock

When ownership is transferred (by gift, sale or whatever) to a person or entity, the seller provides the recipient with a piece of paper such as a stock certificate or option to buy stock. Before you do this, print a legend on the face of it. The legend will refer to a letter that outlines the restrictions by which the ownership interest is encumbered. Here is a sample legend:

### *Sample Restricted Stock Legend*

*The shares represented by this certificate have been acquired for investment and have not been registered under the Securities Act of 1933. Such shares may not be sold or transferred or pledged in the absence of such registration unless the company receives an opinion of counsel reasonably acceptable to the company stating that such sale or transfer is exempt from the registration and prospectus delivery requirements of said act. In addition, the use and transfer of*

## Quick Take

**When gifting, issuing, transferring or selling ownership interests in your business, such as stock, units, warrants, options or convertible securities, talk to your attorney. Tell him or her you want to:**

- Restrict transfer or sale.
- Get a right of first refusal on future transfers, for both you and your company.
- Prohibit hypothecation (pledging interest as collateral for a loan).
- Investigate tax implications.
- Put an agreement in place that addresses what will occur if and when the employee departs if shares are provided to an employee as incentive.
- Be sure to comply with securities laws.

**these shares is limited and restricted by an investment agreement, copies of which may be obtained at no cost by written request made by the holder of record of this certificate to the secretary of the corporation at the principal executive offices of the corporation.**

No doubt you noticed the SEC language that dominates the above. There are strict and complex laws that govern transfers of ownership interest in companies. Certainly, you don't want to run afoul of them. It is common practice to include in any stock legend protective language that addresses these laws, so we've included it in ours. The language that is germane to this article is found at the end of the sample legend and is in bold. But the SEC language alone places some burdens on the transfer of shares.

Again, this legend would be printed prominently on the stock certificate or other piece of paper that evidenced the ownership interest. Note that the above is just a sample. Talk to your attorney before transferring any ownership interest. We highly recommend that if your primary attorney is not experienced in private business ownership transfers (i.e., securities), find one who is.

**Investment Letter:** This is simply a document that outlines restrictions on ownership interest. It could have any number of names, such as stockholder agreement. We suggest that it provide the following restrictions:

1. Restrict future sale or transfer of the shares.
2. Grant a right of first refusal to both you and your company.
3. Prohibit pledging of the stock as collateral for a loan or other transaction (referred to as "hypothecate").
4. Require compliance with federal and state securities ("blue sky") laws.

*continued on next page*

### **Protect Yourself When Giving, Selling or Transferring Ownership, continued from previous page**

5. Shares are and remain subject to the terms of any stockholder agreement, buy-sell agreement, employee ownership plan or option plan, or any other agreement that might be in effect. Be sure to include name and execution date of any such documents. See page 14 for a sample Investment Letter.

**Right of First Refusal:** This gives you some control over who might become an owner of your business by sale or other transfer of shares that are held by a person or entity to whom you have sold or given shares. We say “some” control because transfer is not prohibited, but a right of first refusal will give you the right and ability to block a transfer by matching the terms under which a transfer is set to take place.

*Note: You might ask why we don't suggest you simply prohibit a transfer. This, of course, would be ideal, but it is our understanding that case law holds that such a provision might constitute “unreasonable restraint” and thereby be rendered void and unenforceable. Check with your attorney.*

**Buy-Sell Agreement:** We strongly suggest that every business with multiple owners executes a buy-sell agreement, possibly funded by life insurance, which provides for automatic purchase/sale of shares upon the death, disability or retirement of any of the owners. There are two primary types:

Stock redemption: Corporation buys stock from stockholder(s).

Cross-purchase: Individual stockholders buy stock from one another.

Be sure to consult your tax advisor or attorney, because there could be differing tax results among the different types of transactions.

In addition, the buy-sell agreement can specify whether it is mandatory (you must buy the stock) or optional (right-of-first-refusal). The agreement should establish the price at which the interests will be purchased/sold. And instead of a set or static price, we suggest that the agreement include a formula for determining value, one that will continue to remain valid and “fair” as the business evolves and changes over time. Failure to have such a provision will almost certainly result in a dispute over valuation.

**Employee Stock Ownership Agreement:** If you award or sell ownership or options on ownership to employees as a way of attracting and retaining key employees, you must put in place an agreement that governs and restricts the employee's ownership of the stock. The agreement should make the shares subject to all the restrictions discussed in this article, but also address what occurs if and when the employee departs your company. Typically, options become void and interests are re-purchased. If, for any reason, employees retain ownership of shares after they depart your employ, will they have a right to data on your company if they go to work for or become a competitor?

**Caution for S-Corporations:** If your business is an S-corporation, you should include an automatic restriction on the sale or transfer of any stock position that would invalidate the tax status of your

S-corp. This is because the transfer of stock to another corporation would disqualify a business from being taxed as an S-corp. As a result, you would revert back to a C-corporation — and you know what **that** means (i.e., double taxation).

In summary, when selling or issuing ownership interest in your company, do the following:

1. Seek the advice of an attorney skilled and experienced in securities laws.
2. Legend the stock certificate.
3. Execute an investment agreement.
4. Restrict the transfer or sale.
5. Get a right of first refusal on future transfers, for both you and your company.
6. Prohibit hypothecation (pledging of the interest as collateral for a loan).
7. Prior to any transfer, investigate the tax implications to both parties.
8. If the shares are provided to an employee as incentive, put an agreement in place that addresses what will occur if and when the employee departs.
9. Take prudent and proper action not to run afoul of state and federal securities laws.

Do these things and you will save yourself considerable time, money and trouble over the years. □

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## You Can't Sell Ownership to Just Anyone

Among the many issues to consider when selling ownership in your business is whom you sell to. Sell to an unsophisticated buyer with limited net worth and you're asking for trouble. He or she might be able to rescind the transaction on legal grounds because there are rules about who qualifies for buying stock or other equity interests, particularly in a closely held business. You should take great caution before you sell ownership to anyone who does not meet the following criteria:

1. Is sufficiently sophisticated and knowledgeable in business affairs, so as to understand risks of the business and the investment. Or is represented by a knowledgeable investment adviser and lawyer.
2. Understands restrictions on the stock.
3. Has sufficient financial capacity (net worth) to absorb any loss in the investment.

Always use a lawyer experienced in securities transactions when you sell stock and equity interests in a business. □

**Sample Investment Letter**

Re: Share Acquisition

Dear (Seller's Name):

In connection with your private sale of stock to me of 500 common shares, par value \$\_\_\_\_\_ (referred to herein as the "Shares"), of XYZ Corp. (the "Company"), I hereby represent that:

- (i) I am acquiring these shares for my account and for the purpose of investment and not with a view to distribution, and I will not dispose of such shares in any manner that would involve a violation of applicable securities laws;
- (ii) I have had the opportunity to ask questions of, and to receive answers from, the Company with respect to my acquisition of the Shares. I have been given full access to such financial and other information for me to make a fully informed decision as to investing in the Shares;
- (iii) I have been advised and understand that these shares have not been registered under the Securities Act of 1933 (the "Act"), are "restricted securities" within the meaning of Rule 144 under the Act, are subject to restrictions on transfer, and that the Company is under no obligation to register these shares under the Act or to take any action that would make available to me any exemption from such registration;
- (iv) I have not received any offer to acquire the Shares pursuant to any advertisement, article, notice, or any other communication published in any newspaper, magazine, or similar broadcast media;
- (iv) I understand that no federal or state agency has made any finding or determination as to the fairness for investment of the Shares;
- (v) I understand that investing in the Shares is highly speculative;
- (vi) I am an "accredited investor" as that term is defined in Rule 501(a) of Regulation D under the Securities Act; and
- (vii) I understand that the certificates for such Shares shall bear an appropriate legend restricting transfer in accordance with applicable securities laws and the terms of a shareholders agreement.

You are authorized to deliver the enclosed additional signed copy of this agreement to the Company, and this agreement shall be enforceable directly by the Company.

\_\_\_\_\_  
Signature                      Date

\_\_\_\_\_  
Printed Name

**THIS IS ONLY A SAMPLE LETTER. CONSULT WITH LEGAL COUNSEL BEFORE USING IT.**

# Bookkeeping and Accounting Basics

While keeping track of your business's finances may seem overwhelming, it's not that hard when you know the basics of accounting and bookkeeping. Bookkeeping and accounting share two basic goals:

- A. To keep track of your income and expenses, which improves your chances of making a profit.
- B. To collect the financial information necessary for filing your various tax returns.

**Financial reports are important because they bring together several key pieces of financial information about your business in one place.**

Sounds pretty simple, doesn't it? It can be, especially if you remind yourself of these two goals whenever you feel overwhelmed by the details of keeping your financial records.

There is no requirement that your records be kept in any particular way. As long as your records accurately reflect your business's income and expenses, the IRS will find them

acceptable. (There is a requirement, however, that some businesses use a certain method of crediting their accounts: the cash method or accrual method. If you don't know whether your business is required to use one or the other, check with your accountant.)

## Three Steps to Keeping Your Books

The actual process of keeping your books is easy to understand when broken down into three steps.

1. Keep receipts or other documentation of every payment made and every expenditure by your business.
2. Summarize your income and expenditure records on some periodic basis (daily, weekly, or monthly).
3. Use your summaries to create financial reports that will tell you specific information about your business, such as how much monthly profit you're making or how much your business is worth at a specific point in time.

Whether you do your accounting by hand on ledger sheets or use accounting software, these principles are exactly the same.

### Step One: Keeping Your Receipts

Each of your business's sales and purchases must be backed by some type of record containing the amount, the date, and other relevant information about that sale. You'll use these to create summaries of your transactions.

From a legal point of view, your method of keeping receipts can range from slips kept in a cigar box to a sophisticated cash register hooked into a computer system. Practically, you'll want to choose a system that fits your business needs. For example, a small service business that handles only relatively few jobs may get by with a bare-bones approach. But the more sales and expenditures your business makes, the better your receipt filing system needs to be.

### Step Two: Setting Up and Posting to Ledgers

A completed ledger is really nothing more than a summary of revenues, expenditures, and whatever else you're keeping track of (entered from your receipts according to category and date).

Later, you'll use these summaries to answer specific financial questions about your business, such as whether you're making a profit and, if so, how much.

On some regular basis — like every day, once a week, or at least once a month — you should transfer the amounts from your receipts for sales and purchases into your ledger. This is called "posting;" how often you do this depends on how many sales and expenditures your business makes, and how detailed you want your books to be.

Generally speaking, the more sales you do, the more often you should post to your ledger. A retail store, for instance, that does hundreds of sales amounting to thousands or tens of thousands of dollars every day should post daily. With that volume of sales, it's important to see what's happening every day and not to fall behind with the paperwork. To do this, the busy retailer should use a cash register that totals and posts the day's sales to a computerized bookkeeping system at the push of a button. A slower business, however, or one with just a few large transactions per month, such as a small website design shop, dog-sitting service, or swimming-pool repair company, would probably be fine if it posted weekly or even monthly.

You can purchase an accounting software program that will generate its own ledgers as you enter your information (and then automatically generate the necessary financial reports from the same information). All but the tiniest new businesses are well advised to use an accounting software package to help keep their books (and micro-businesses can get by with personal finance software such as Quicken).

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### Step Three: Creating Basic Financial Reports

Financial reports are important because they bring together several key pieces of financial information about your business in one place. Think of it this way: while your income ledger may tell you that your business brought in a lot of money during the year, you may have no way of knowing whether you turned a profit without measuring your income against your total expenses. And even comparing your monthly totals of income and expenses won't tell you whether your credit customers are paying fast enough to keep adequate cash flowing through your business to pay your bills on time.

That's why you need financial reports: to combine data from your ledgers and sculpt it into a shape that shows you the big picture of your business. The key reports you need to create regularly are a cash flow analysis, a profit and loss forecast, and a balance sheet. (Both QuickBooks and Quicken Home and Business, as well as other accounting software, can provide these regular reports.) □

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