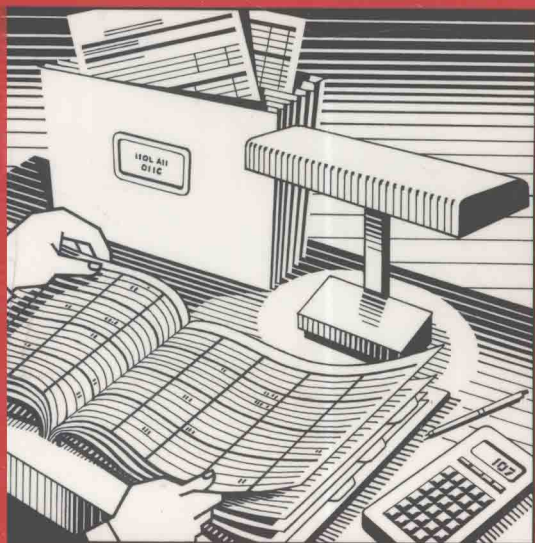




A WILEY SMALL BUSINESS EDITION

# SELF-DEFENSE FINANCE *for* SMALL BUSINESSES



- How to write business plans and financial statements
- How to negotiate with bankers
- Includes cash-flow statements and capital budgeting
- Provides actual case histories

## WILBUR M. YEGGE

# Self-Defense Finance

FOR SMALL BUSINESSES

**Wilbur M. Yegge, CBC, Ph.D.**

*NAM/Wiley Series in Manufacturing*



John Wiley & Sons, Inc.

New York ♦ Chichester ♦ Brisbane ♦ Toronto ♦ Singapore

This text is printed on acid-free paper.

Copyright © 1995 by Wilbur M. Yegge  
Published by John Wiley & Sons, Inc.

All rights reserved. Published simultaneously in Canada.

Reproduction or translation of any part of this work beyond that permitted by Section 107 or 108 of the 1976 United States Copyright Act without the permission of the copyright owner is unlawful. Requests for permission or further information should be addressed to the Permissions Department, John Wiley & Sons, Inc.

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional person should be sought.

*Library of Congress Cataloging-in-Publication Data*

Yegge, Wilbur M.

Self-defense finance for small businesses / Wilbur M. Yegge.

p. cm.

Includes bibliographical references.

ISBN 0-471-12294-7 (cloth : alk. paper). — ISBN 0-471-12295-5  
(pbk. : alk. paper)

1. New business enterprises—Finance. 2. New business  
enterprises—Planning. 3. Small business—Finance. 4. Small  
business—Planning. I. Title.

HG4027.6.Y44 1995

658.15'92—dc20

95-11737

Printed in the United States of America

10 9 8 7 6 5 4 3 2

# Self-Defense Finances

## WILEY SMALL BUSINESS EDITIONS

Jeffrey G. Allen, *Complying with the ADA: A Small Business Guide to Hiring and Employing the Disabled*

Kim Baker and Sunny Baker, *How to Promote, Publicize, and Advertise Your Growing Business*

Robert A. Cooke, *Doing Business Tax-Free: Perfectly Legal Techniques to Reduce or Eliminate Your Federal Business Taxes*

Jeff Davidson, *Marketing on a Shoestring: Low-Cost Tips for Marketing Your Products or Services*

Fred E. Hahn, *Do-It-Yourself Advertising: How to Produce Great Ads, Brochures, Catalogs, Direct Mail, and Much More*

Daryl Allen Hall, *1001 Businesses You Can Start from Home*

Daryl Allen Hall, *1101 Businesses You Can Start from Home, Revised and Expanded Edition*

Herman Holtz, *How to Start and Run a Writing and Editing Business*

John Kremer, *The Complete Direct Marketing Sourcebook: A Step-by-Step Guide to Organizing and Managing a Successful Direct Marketing Program*

Harold J. McLaughlin, *The Entrepreneur's Guide to Building a Better Business Plan: A Step-by-Step Approach*

Richard L. Porterfield, *The Insider's Guide to Winning Government Contracts*

Wilbur M. Yegge, *Self-Defense Finance for Small Businesses*

# About the NAM

The National Association of Manufacturers (NAM) is the nation's oldest and largest broad-based industrial trade association. Its more than 13,000 member companies and subsidiaries, including 9,000 small manufacturers, are located in every state and produce approximately 85 percent of U.S. manufactured goods. Through its member companies and affiliated associations, the NAM represents every industrial sector, 185,000 businesses, and more than 18 million employees.

The NAM's mission is to enhance the competitiveness of manufacturers by shaping a legislative and regulatory environment conducive to U.S. economic growth in a global economy, and to increase understanding among policymakers, the media, and the general public about the importance of manufacturing to America's economic strength and standard of living.

The NAM is headquartered in Washington, D.C., and has regional offices across the nation. For more information on the NAM, call 202-637-3000.

# Dedication

There are over ten million nonagricultural small businesses in the United States, and they represent over 95% of the nation's total businesses. Irrespective of the magnificence of their larger counterparts, small businesses account for nearly 60% of all private employment and almost one-half of total business output. Small business contributes over half of all industrial innovation, which is produced at substantially less cost than that which is incurred by large business. Employment growth coming from the small-business sector is nearly nine times greater than that coming from other sectors. The effect brought about by small business on the total U.S. economy is of major importance to us all.

Although these data paint a land-of-opportunity picture, according to the U.S. Small Business Administration (SBA), it must be noted that over 80% of all businesses fail in their first ten years of operation. Fifty-three percent of these businesses will fail by the end of their fifth year, while fewer than 20% fail after ten years in operation. Overwhelmingly, the major cause of this failure is weak management. Individuals usually go into business because of an acquired skill in production or sales and seldom possess the knowledge necessary to manage all aspects of the business. This is especially true in the critical area of finance. Financial management need not be complicated. It is the goal of this handbook for you to immediately begin using these tools in your business.

This handbook is dedicated to the millions of small-business owners who struggle, work, and survive in what sometimes appears to be a hostile environment, always courting the word NO.

# Acknowledgments

The scope of experience reflected in this handbook is the result of many years of education, applied practice, and accumulated contributions from many business and professional individuals (who, by passage of time, leave their mark rather than name) to be acknowledged. Six persons, however, deserve special recognition. I thank Christopher Micklatcher, Attorney and C.P.A., and Thomas F. Dobens, C.P.A., for their willingness to review concepts and mechanical application. I thank Richard Nass, BS Mathematics, MBA Accounting, and James Whitney, BSBA, MBA, MS Education, course work completed DBA studies, for their willingness to review both text and mechanical presentation. All four have had many years of experience in working with small, privately owned businesses. A special thanks to Mary Rich, whose aid and assistance were given freely in proof-reading my manuscript. It is a pleasure to acknowledge Michael Hamilton, senior editor at John Wiley & Sons, Inc., whose thoughtful suggestions and enthusiasm for the manuscript were invaluable. Michael also taught me something about the publishing world that no book or seminar has been able to teach. I owe him a deep debt of gratitude.



# About the Author

Nineteen ninety-four marks the passage of ten years in the field of small-business consulting and 15 years in other small-business ownership for me. This, I believe, is a relatively long time for a man to survive without the trappings and, yes, the safety of the corporate cocoon, where I spent the previous years of my business life. Somewhere along the line, I found time to acquire graduate degrees in both psychology and business. Without the blending of these two disciplines, I might still be in the corporate environment.

My first and second adventures into small-business ownership were start-up situations and successful by both then and today's standards. The first was an automatic letter writing and data processing business, which when sold in 1968 was producing nearly four hundred thousand dollars of sales. Today, that business has sales in excess of 15 million dollars and provides jobs for 50 people. A second venture was the establishment of a management consulting firm in Boston, Massachusetts. During graduate school, I worked part-time in a consulting firm, and through both college and work experience, I learned not only the value of "cramdown" scheduling for achievement during 16-hour days but also the framework for building a consulting practice of my own. Three years after its inception, and one year after graduation from college, my consulting practice was profitably sold. Offices of this company were operating in Boston, Houston, and Los Angeles. We were 20 professionals in all and had annual billings of six hundred thousand dollars for our services. My bright, shiny,

and new Master's in business told me to move on when I was invited into the exciting prospect described through my education for the large, multinational corporate life.

Six-plus years at this corporation introduced me to many wonderful experiences, among which was their mergers and acquisitions department, where I worked under the toughest boss in my career. He was also the best of all those before and after him. Much of my present day entrepreneurial belief system was molded during these "high-flying," leverage buy-out times of the late 1960s and early 1970s. I progressed to the head of the acquisition team before this corporation was acquired by still a larger giant. This, too, was a valuable education, but one best left to tell at another time. When my boss fell under the proverbial ax customarily wielded on those at the top of acquired companies, I realized that it was time to move on again.

My third and fourth business purchases were not as successful. These occurred after tenure in the corporate world and, perhaps, after decision making on my part became too molded by those stratified corporate philosophies. The third adventure was the purchase of a bankrupt company. Short on personal capital, I leveraged and put too much of my personal self on the line. I learned from my mistakes, however, and made the next leverage purchase from bankruptcy proceedings, before returning to the consulting field once again. No loss, or real profit for that matter, was made in either venture, but I clearly learned the value of planning for financial control. Entrepreneurs, it is said, are made when, because of business conditions, they miss their first payroll. With commonsense planning and through appropriate control, it is not necessary to get this close to failure. Andrew Carnegie said, "Concentrate. Put all your eggs in one basket, and watch that basket."

Operating a business is not easy, nor is the task of buying or selling a business. My father, during the 1940s and 1950s, who always paid cash for what he bought in his restaurant business, had a simple philosophy about accounting: "If I start the day with  $x$  dollars in cash, pay my bills in cash as I go along, and then end up with  $x$  plus  $y$  dollars of sales in cash, what's left over is the profit for the day. Applied and managed thus daily, this is all the accounting I need." He had only an eighth grade education, but he succeeded in providing for his family throughout his life.

"Shoebox" record keeping still exists today, but there are so many more variables that now come into play. Through the years, buyers, sellers, lawyers, accountants, and middlemen perpetuate a need to add value, justifying the expense of their time. Legislators passed into law complex rules

that exacerbate even the simplest of business operations. Out-of-control spending on the part of government led to complex tax structuring schemes to fund government expansion. Small business has been forced into applying big-business principles for small-business survival.

Overall, it is a picture that reminds me of an ancient battle and the poor judgment of two generals. Perhaps you will recall from Roman history the battle strategy referred to as the “Phalanx.” Opposing legions faced each other in closely formed wedges, appearing much like the pins at a bowling alley. The intended purpose was to advance and confront each other, point to point. Weapons of that day were comprised largely of shield and sword, carried by a foot soldier. With only a shield on the left hand and sword on the right, you might imagine the feeling of bodily exposure for men at the point and all along the wedge to the right-hand side. A natural tendency was for each phalanx to “shift” left with distance, each seeking the safety and comfort of shield. A successful strategy of generals was found in the skillful positioning of their armies in proximity close enough to engage each other before a significant shift was to occur. History records at least one great battle where two generals misjudged the distance and their armies passed without either striking a blow. So much confusion existed between the two sides that the battle was ultimately put off to be fought on another day.

I often think of this story when working for the small-business owner, where too many generals seem to be present in the decision-making process. The only generals who count are the ones with their backs on the line. President Harry S. Truman made famous the saying, “The buck stops here!” He rose from the bankruptcy of his small Missouri haberdashery business to statesman and, finally, to president of the United States. Throughout his life, he collected information, learned from this information, made *his* decisions, and stuck by *his* guns.

It is my hope that this text brings credible logic to the arduous *process* that some of us go through while deciphering various elements of business finance. It is also my hope that the suggestions offered herein will lend strength to the business owner when confronted by the opinions of accountants, lawyers, buyers, sellers, business brokers, mothers, fathers, mothers-in-law, and fathers-in-law. I add the last four categories to emphasize the very real possibility in small business for the “blue-sky” dilemma, presented in an old real estate story, to occur—the one where a consulted father-in-law, a self-ordained expert, kills the proposed deal. After all, many of us finance some of our ventures through the benefit of family owned capital.

It is my further hope that you will send comments, thoughts, constructive criticisms, or other ideas that may improve the quality of this handbook for others and for future editions. Also, I would like to hear about your experiences in using this text.

WMY

# Preface

As most of our careers advance, we eventually steer a course into the mature and hopefully growing field that reflects our previous training. Some of us take charge in our jobs and contribute significantly to the management style, creative aspects, and/or the technical elements in our chosen fields, while others may feel more secure in following the footsteps provided by others who went before them. Only a few persons will strike out each year into unproven ventures, such as the purchase of a small business of their own. The task before these few is large and requires all the tenacity, intelligence, and common sense they can muster for eventual success.

There are some very good reasons why private business ownership is not for everyone. Among the chief reasons are security and peace of mind. The stress generated by starting, owning, and operating a small business is unparalleled by that in most of life's adventures. Regardless of one's strength of conviction, that business-related stress will eventually carry over into family life, and the existence of strong family relationships is essential to appropriately handle those inevitable times when the business puts our survival at risk. It is important to consider well our marital situations and make appropriate time for family life.

Work loads, although we may have unfinished business at the end of a day, are traditionally *scheduled* for us in the corporate environment. Bottlenecks in assignments can be distributed to others to even out the work flow. Small-business owners more often find themselves in the roles of

“chief cooks and bottle washers,” when they must unilaterally wear the corporate hats of CEO and CFO and perform management, marketing, sales, purchasing, stocking, and accounting tasks without the benefit of assistants. It is not uncommon for many business owners to attire in janitorial regalia when the business day has ended. A business life for most owners is usually not at all what was first envisioned and clearly less than those carefree allusions to quiescent business drama as seen in the movies.

Mr. Kenneth Olsen founded Digital Equipment Corporation in the garage of his home. I’m confident that in earlier years he missed the community found in working with others. With the aid of venture capital and his university ties, we, today, know the magnitude of his achievements. This is one example of fulfilling dreams envisioned by many entering private enterprise. Some people will achieve similar lofty goals, but many more will be content and happy with their company remaining small . . . to continue in their roles of sole proprietor, performing as much as they can, and then agonizing over what is left undone.

This text is directed to those several million independent businesspeople who market products or services and who are without the benefit of a chief financial officer in their employ. It incorporates personal experiences derived from assignments during ten years of small-business consulting, the adventures from 15 years of ownership and sale of small businesses, and the thoughts and comments from other business owners and their advising professionals. It is tempered by knowledge gained from the unfortunate drama played out in nearly 40 bankruptcy proceeding assignments. And it provides insight into the traditional roles played by bankers, accountants, attorneys, buyers, and sellers, whenever these parties are facilitating or affecting aspects of the economic cycle of the small business.

My hope is that, as you read this handbook, you will find guidance in resolving issues surrounding management finance, which have been difficult in handling alone. My further hope is that, through studying the text, you will be better prepared to know *when* to seek professional assistance while a problem is still malleable. It takes courage to ask for help, but courageous men and women enjoy the most success.

*Wilbur M. Yegge, CBC, Ph.D.*

*W. M. Yegge & Company*

*Wells, Maine*

# Introduction

A preordained logic to organization of chapters in this handbook may not at first seem readily clear. There is, however, a certain specific purpose. Every service or product, to include the writing of books, begs creation of a *marketing and financial plan*. We each need and deserve some form of compensation for our work. This can come in the form of emotional and financial reward. Frankly, I expect to receive both through writing this handbook. From elementary SBA publications to scholarly works, I have not yet found a text that truly addresses the *average* of problems incurred by nontech, “mom and pop,” or “lifestyle”-type businesses. Publications tend to be either too simple for any real use or too academic to fit in with constant time demands placed on the owner of the small and, perhaps, lifestyle-type business. For the purpose of this handbook, I define lifestyle ventures as “businesses that are restricted in sales by the size of the local economy and population.” Examples might be the corner grocery store, restaurant, small motel, retail store, accountant, lawyer, doctor, therapist, etc., or businesses that would be owner run, often from a single location. Further definition might be “businesses that encompass the previous statement, and that to substantially grow beyond these conditions would require *cloning* the business at other locations.” With some exceptions, these businesses often have sales of three million dollars or less and seldom have a stable year-round work force of more than 15 employees. Examples of lifestyle manufacturing or distribution businesses might be those with products or services where transportation or a pre-

dominance of similar-type competitors prevent serious entry into more distant markets. Some businesses with five, ten, or more million dollars of sales also fit into this lifestyle category. For a business to be lifestyle in nature does not mean that handsome profits cannot be made.

Other texts about closely held business generally use case examples from the larger and better-established small businesses. Most address their subject well but miss elements that are directly related to the much smaller entrepreneur. For example, this handbook, while it does not violate established principles of finance and accounting, is *written* from a *business owner's* point of view. The sample cases of XYZ and ABC companies make use of **positive cash flow** examples to emphasize salient points. *Many text* examples will *use the negative* income and balance sheet to highlight the author's application of financial tools. Perhaps this is simply the psychologist coming out in me. I like to think positively and be around positive-thinking people.

Chapters in this handbook are organized along the line of their usefulness, as described to me by clients, students, and beginning entrepreneurs. For example, some people, because of an existing skill level, require no more than the overview on writing business plans, which is provided in Chapter 1. Even if this is the case, then in view of my "Marketing and Monetary Logic," I still want my handbook to be purchased. If Chapter 1 is insufficient guidance for meeting previously acquired skill, then Chapter 2 provides details on financial statement analysis and could represent all that is required. (Of course, I still want my handbook to be purchased.) Subsequent chapters are thus arranged along lines of their possible and sequential useful need.

My "mission statement" or purpose for this handbook reads as follows: "To write a book, not necessarily a scholarly rendering, but one that is completely educational, which provides guidelines to address issues surrounding the major reason why so many small businesses fail. A handbook that relates to the needs of persons who want to be in business for themselves and want also to take personal control of their business's direction. Finally, to write in a *user-friendly* manner."

My "target market" is a large sector of nonagricultural small-business owners who operate grocery stores, restaurants, small motels, smaller-sized manufacturing, single-store retail, small group or single professional practices, nontech start-up businesses, etc. This segment is often overlooked in publications due to their size and insignificant, singular role in the more global economy. Additionally, this text is for those people who themselves are from lifestyle businesses and who provide accounting, fi-



nancial, and legal advice to independent owners. This text is also directed to commercial bankers who analyze and provide capital to smaller enterprise. Without them, many more small businesses would not survive. Finally, this text is directed to would-be business owners contemplating their first purchase.