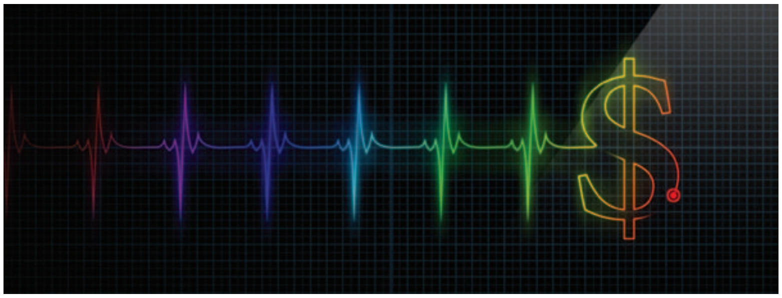
BUSINESS MATTERS

WINTER 2013

CASH FLOW IS YOUR COMPANY'S LIFEBLOOD — MONITOR IT CLOSELY

While growth and profitability are good measures of your business's success, cash flow may better reflect its overall health. Cash flow is what allows you to meet current financial obligations — to employees, vendors and other creditors — and without it your company's future is uncertain.



In fact, many of the businesses that failed during the recent economic downturn can blame cash-flow problems such as low collection rates or the inability to secure lines of credit. You can keep this from happening to your business if you understand how your decisions affect the availability of funds.

2 ANALYTICAL TOOLS

Two tools enable you to analyze your business's cash flow:

1. Detailed budget. Maintaining a detailed budget for all expenditures can be tedious, but it's essential to good cash flow management. Budget items should tie into and support overall business objectives. If you can't demonstrate how an item supports a specific goal, question its inclusion. Such scrutiny helps you avoid unnecessary spending and makes more cash available for higher priorities.

Keep in mind that your budget is useful as an analytical tool only if it accurately reflects current spending. So update it regularly.

2. Cash flow statement. This statement is designed to report your business's net increase or decrease in cash. It factors in the cash inflows and outflows of daily business operations, asset purchases and sale proceeds, and financing activities. Because it excludes noncash accounting items, it can help you pinpoint cash flow problems.

Cash flow statements are particularly useful when prepared monthly. This won't be difficult if you have accounting software and use your budget as an initial input.

CASH OPPORTUNITIES

Once you know how your cash flows, look for opportunities to improve that flow. For many businesses, such opportunities lie in their accounts receivable department.

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Business structure basics

HAVE YOU CHOSEN THE RIGHT ENTITY?

Choosing a business structure, or entity, is an important decision that requires owners to consider several factors. The right structure depends on your circumstances, which may change over time.

3 ENTITIES

One-person businesses often start out as sole proprietorships because they're easy to set up and operate. But such structures offer no protection against personal liability. Partnerships don't provide liability protection either — at least to their general partners. That's why most established businesses operate as one of three entities: C corporation, S corporation or limited liability company (LLC).

All three structures limit their owners' exposure to personal liability for their company's debts and obligations. But they can differ greatly when it comes to flexibility, taxes and access to financing.

FLEXIBILITY AND FORMALITIES

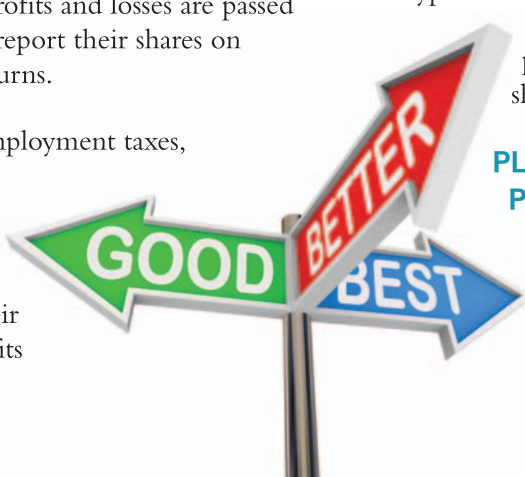
LLCs generally offer more flexibility than C and S corporations. They're relatively easy to set up and have few restrictions and corporate formalities. Members have flexibility in the allocation of profits and losses.

By contrast, S corporations can't have more than 100 shareholders (though most members of the same family are treated as a single shareholder) or more than one class of stock. Also, eligible S corporation shareholders are limited to individuals, certain trusts and tax-exempt organizations, and employee stock ownership plans (ESOPs).

TAX CONSIDERATIONS

S corporations and LLCs are "pass-through" entities. This means that all of their profits and losses are passed through to the owners, who report their shares on their personal income tax returns.

But when it comes to self-employment taxes, S corporations may have an advantage: LLC members, unlike S corporation shareholders, may be subject to self-employment taxes on their entire profits, even if the profits aren't distributed to them. However, S corporations must pay "reasonable" salaries to owner-employees, which are subject to self-employment tax.



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C corporations have one distinct tax *dis*advantage: Their profits are subject to corporate income tax at the entity level and then to personal income tax when they're distributed as dividends to shareholders. However, to the extent the C corporation is able to distribute profits in the form of salaries and bonuses (keeping in mind "reasonable compensation" restrictions), the deduction for wages paid eliminates double taxation.

C corporations also have some tax advantages. They may be able to deduct employee benefits — such as health reimbursement plans — for owners. Additionally, due to the graduated tax rates of a C corporation, a business may be able to build up and retain capital at a lower current tax rate than it would as an LLC or S corporation.

ATTRACTING FINANCING

S corporations can have trouble attracting equity investors because of limits on the number of shareholders and their inability to issue preferred stock. LLCs, on the other hand, are allowed an unlimited number of investors and enjoy the flexibility to create different types of interests to meet investors' needs.

All types of business entities have access to bank loans. But banks may be more likely to ask for personal guarantees from S corporation shareholders and LLC members.

PLANNING AND PROFESSIONAL ADVICE

Choosing a structure for your business is a complex process. But with planning and professional advice you can find the right entity for your needs. ■

6 QUESTIONS TO ASK BEFORE REFINANCING YOUR MORTGAGE

In September, the Federal Reserve announced plans to keep the Fed funds rate at "exceptionally low levels" at least through mid-2015. So if you haven't already refinanced your mortgage, you probably have time to weigh the decision.

Low rates are just one consideration. You also need to answer the following questions:

1. How's your credit? Credit standards have tightened dramatically. To refinance — and qualify for the best rates — you'll likely need an excellent credit score.

2. What's your equity? To qualify for the best rates, you generally must have equity in your home of at least 20%. If your home's value has dropped, you may need to make a lump-sum payment toward equity. And if you're "under water" — you owe more on your mortgage than your home is worth — you may not qualify for refinancing at all.

3. How long do you expect to be in your home? Refinancing can lower your monthly mortgage costs, perhaps significantly, and the longer you remain in your home, the greater your overall savings. So if you move in the near term, you might not realize much benefit after you take into account closing costs — averaging more than $3,700 nationally on a $200,000 mortgage, according to a Bankrate.com survey.

4. What's your mortgage rate? The lower your current rate, the less room you'll have to reduce your payments by refinancing, and the longer it will take to make back the closing costs.

5. Is your mortgage rate adjustable? Adjustable rate mortgages can be risky because, when inflation rises, your mortgage rate will reset significantly higher. So you might benefit from refinancing to a fixed-rate loan, perhaps paying slightly more in the near term but locking in a historically low rate over the longer run.

6. How long have you had your mortgage? Refinancing restarts your debt clock. Weigh the benefits of lower monthly payments against the costs of starting from scratch with a new mortgage.

Alternatively, low interest rates might enable you to reduce your mortgage length — for example, by moving from a 30- to a 20-year mortgage. This may mean the same or slightly higher current payments, but it will allow you to substantially reduce your interest costs over the loan's life. ■

HOW AN ILIT CAN SOLVE YOUR ESTATE PLANNING QUANDARIES

Do you worry that your heirs won't have sufficient cash to pay estate taxes when you die? Or that your life insurance policy's value might cause you to exceed your lifetime estate and generation-skipping transfer tax exemptions?

An irrevocable life insurance trust (ILIT) — which removes your policy's proceeds from your taxable estate — is a potential solution. However, understand that, when you place a life insurance policy in an ILIT, you relinquish ownership and control. You appoint a trustee to handle tasks such as changing beneficiaries and making adjustments to the policy.

Another potential drawback: For your insurance proceeds to be excluded from your estate, you must live for three years after transferring the policy to the ILIT. However, the three-year rule doesn't apply if you instead contribute funds to the trust and the ILIT purchases a new policy.

ILITs can be complicated, and they need to be set up properly by a professional. Talk with your financial advisor about whether an ILIT is appropriate for you or if another type of trust might better meet your needs.

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To minimize the risk of slow collections, conduct credit and reference checks on new customers and require them to provide deposits on orders or services to be rendered. Promptly send invoices to customers — by e-mail for faster delivery — and offer discounts for early payments. Also, don't wait until accounts are 60 to 90 days late before contacting customers.

For more tips on improving cash flow, see "Shortening the cash operating cycle" at right.

BALANCING ACT

Cash-flow management can be a high-wire act. You can't forgo growth. But as you grow your business, you'll naturally have more operational costs, which will hamper cash flow. For help in striking the right balance, talk to your financial advisor. ■

SHORTENING THE CASH OPERATING CYCLE

For many businesses, the key to managing cash flow is to shorten the cash operating cycle. Consider doing the following:

- Increase prices.
- Lower inventory by writing off obsolete items.
- Stretch payments on accounts payable.
- Cut operating expenses.
- Minimize taxes through effective tax planning.