BUSINESS

NO MARGIN, **NO MISSION**

> *"Everyone to whom much was given, of him much will be required, and from him to whom they entrusted much, they will demand the more."*
>
> **Luke 12:48b**

God entrusted you with the business you manage. In Genesis 1 God gave people a garden to rule. God's vision for the future is more like Revelation 21, where people turn that garden into a city with complex infrastructure and flourishing commerce. You too can steward your business from surviving to thriving, but it can be tricky. For managers who come from backgrounds in anything other than finance, keeping tabs on your company's numbers can be a challenge, especially if you've typically offloaded this job to an accountant or possibly a CFO. But hiding in those numbers are signs of both risk and opportunity. This primer reviews three basic financial statements and key ratios that every leader needs to understand well. The goal is to help you steward what you've been given, in good times and in bad, while possibly clearing up some neglected areas for even the most veteran of leaders. Today we will help one another master business fundamentals. As stewards of business as ministry platforms, it's doubly important because, *no margin, no mission!*[1]

Don't Get Blindsided

In 1968 legendary football coach Vince Lombardi famously kicked off a talk to championship players with, *"Gentlemen, this is a football."* He learned that despite the professional prowess of the team, assumptions even on fundamentals can be the difference between ultimate wins and losses. The #1 reason a C12 peer steps away from a C12 Group table over the years has been **unexpected financial crisis**, often traceable to an insufficient grasp on how to utilize and truly manage fundamentals around financial stewardship. Proverbs 27:23 says it's our job as leaders to know the condition of our business.

ACTION ITEM Grab your company's latest Balance Sheet, Profit & Loss Statement ("Income Statement"), and Cash Flow Statement. How comfortable are you at finding and reading these documents? **Rate yourself on a scale of 1 to 10, 1 if you've never seen these before, 10 if these look like old friends.**

RATING

TAKE AWAYS

THE STATEMENTS YOU NEED TO KNOW & WHY

In **Psalm 139:23-24** David asks God to point out any hidden sign of trouble. When you look at the financial statements that summarize your business, you're really asking the same question. Is there anything worrisome here? Are there opportunities I have overlooked? **The Balance sheet**, **P&L (or Income Statement)**, and **Cash Flow Statement** help you answer these questions.

THE BALANCE SHEET — The **Balance Sheet** is so named because a company's assets are balanced against its liabilities plus owner's equity. In **Luke 12:4-7**, Jesus tells us that God keeps a running tally of everything in the world, down to the number of hairs on your head. Your company's balance sheet mirrors the way God keeps track of everything, so understanding it is the first step in good financial stewardship. Assets on the Balance Sheet are broken into short-term or current assets and long-term assets.

CURRENT ASSETS

CASH

CASH EQUIVALENTS
Certain short-term, highly-liquid investments, such as US treasury bills.

MARKETABLE SECURITIES
Financial instruments your company holds which can be sold immediately if necessary.

ACCOUNTS RECEIVABLE
The money customers owe you (may be offset by a how much you expect to be stiffed, a negative number called "allowance for doubtful accounts.")

INVENTORY

PREPAID EXPENSES
Anything your company has paid in advance such as rent.

LONG-TERM ASSETS

LONG-TERM INVESTMENTS
Financial investments that are not intended to be turned into cash in a year.

FIXED ASSETS
Also called PP&E for Property, Plant and Equipment, these include the land, buildings, or machinery your company owns.

INTANGIBLE ASSETS
Intellectual property and the value of any brands acquired by purchasing another business.

OWNER EQUITY

CONTRIBUTED CAPITAL
Amounts paid into the company by owners or stockholders.

COMMON STOCK
(For corporations) or Owner's Capital (for proprietorships).

PREFERRED STOCK

TREASURY STOCK
If the company acquires some of its own shares.

RETAINED EARNINGS
Accumulated profits that the company has not paid as dividends.

CURRENT LIABILITIES

WAGES

RENT & UTILITIES

TAXES

INTEREST PAYABLE

SHORT-TERM DEBT
Debts payable within one year.

CURRENT PORTION OF LONG-TERM DEBT
Principal payable in the short-term.

CUSTOMER PREPAYMENTS

LONG-TERM LIABILITIES

LONG-TERM DEBT

PENSION FUND LIABILITY

DEFERRED TAX LIABILITY OR OTHER DEFERRED LIABILITIES

ACTION ITEM Take a look at your company's Balance Sheet. What are your biggest financial assets? What are your biggest liabilities? Does anything on the Balance Sheet surprise you? Is there anything you don't understand? **Rate yourself on a scale of 1 to 10 on understanding your Balance Sheet.**

RATING

BALANCE SHEET RATIOS TELL THE LIQUIDITY STORY

Numbers from the Balance Sheet answer an important question: *How liquid is my business right now? Can you cover the cost of a crisis? Can you respond to an opportunity?* You can answer these questions by calculating ratios of liquidity: **The Current Ratio**, the **Quick Ratio**, and the **Cash Ratio**.

The **Current Ratio** tells you how many times your company can pay its current debts with its current assets. How much of a buffer do you have to cover your current liabilities?

CURRENT ASSETS ______ ÷ CURRENT LIABILITIES ______ = **CURRENT RATIO** ______

The **Quick Ratio** and Cash Ratio are calculated similarly to the Current Ratio, except each is a more conservative view of your company's ability to pay-up in a pinch. Unlike the Current Ratio, the Quick Ratio excludes assets like inventory that may not convert easily into cash.

(CASH ______ + CASH EQUIVALENTS ______ + SHORT-TERM INVESTMENTS ______ + ACCOUNTS RECEIVABLE ______) ÷ CURRENT LIABILITIES ______ = **QUICK RATIO** ______

The **Cash Ratio** excludes accounts receivable, on the chance that your company has a long collection window and may need to pay liabilities sooner.

(CASH ______ + CASH EQUIVALENTS ______ + SHORT-TERM INVESTMENTS ______) ÷ CURRENT LIABILITIES ______ = **CASH RATIO** ______

A company might have a Current Ratio of 1.52, a Quick Ratio of 0.71, and a Cash Ratio of 0.19. Taken together, the liquidity ratios give you an idea of whether your company can cover the cost of continuing operations or taking on new projects.

ACTION ITEM Compare your company's **Quick Ratio** and **Cash Ratio** to that of another company in your industry. Look at your competitor's website to see if they publish an earnings report or check with industry/trade publications.[2]

Competitor Name	Quick Ratio
Competitor Name	Cash Ratio

What disciplines or approaches do you find effective for deriving meaningful insights from regular reviews of the Balance Sheet?

TAKE AWAYS

THE P&L — While the Balance Sheet gives you a snapshot of your company's financials at one moment in time, the **Profit and Loss Statement or P&L** reports how much money you made or lost over the past period of time (year-quarter-month), and the cost related to making (or losing) that money. The P&L (sometimes called **Income Statement**) starts with a **revenue** figure which represents all the money your business generated in this period. From that top line number, we take away all the costs of doing business, also called **operating costs**.

OPERATING COSTS

COGS
Cost of goods sold.

SG&A
Selling, general, and administrative expenses.

R&D
Research and development expenses.

OTHER
Various other operating expenses.

Operating profit is what is left when you subtract operating costs from revenue. The P&L then subtracts money paid to two expense categories: **interest expense** and **tax expense**. What's left is net **income**. This is also called **profit**, or simply, **the bottom line.**

ACTION ITEM Take a look at your company's P&L. Are you making a profit? What are your biggest expense categories? Does anything on the P&L surprise you? **Rate yourself on a scale of 1 to 10 on understanding the P&L.**

RATING

RATIOS FROM THE P&L TELL YOU ABOUT MARGIN

In **Matthew 25:14-30** God says he wants his stewards to make a profit. How profitable is your business? To find out, let's calculate three key ratios of margin.

The **Gross Margin** tells you what percent of every dollar is retained to cover your company's fixed costs and debt after subtracting your variable cost of materials.

$$\left(\underset{\text{REVENUE}}{\_\_\_\_\_\_} - \underset{\text{COST OF GOODS SOLD}}{\_\_\_\_\_\_} \right) \div \underset{\text{REVENUE}}{\_\_\_\_\_\_} = \underset{\textbf{GROSS MARGIN}}{\_\_\_\_\_\_}$$

Operating Margin gives you an idea of how much money your company makes on sales before paying for interest and taxes. Since Operating Margin takes into account other costs of doing business, such as wages, it will be lower than gross margin. A particularly low Operating Margin means that you may have a hard time covering fixed costs if business declines.

OPERATING INCOME		REVENUE		**OPERATING MARGIN**
________	÷	________	=	________

Net Margin shows the final profit from your business activities after all expenses are paid.

NET PROFIT		REVENUE		**NET MARGIN**
________	÷	________	=	________

Margins tend to vary widely from industry to industry. A successful technology firm might have a gross margin of 38%, an operating margin of 30%, and a net margin of 18%, while a firm in a slim margin industry such as food services might have a gross margin of 10%, an operating margin of 6%, and a net margin of 3%.

ACTION ITEM If you can, compare your margins to those of competitors. Look on their websites for an earnings report or search for them on Nasdaq.com and calculate their margin ratios.

Competitor Name	Margin
Competitor Name	Margin

How does your profitability compare to your competitors or industry peer group?

TAKE AWAYS

THE CASH FLOW STATEMENT — Cash provides the lifeblood of your business. In **Luke 14:28** Jesus asks if anyone starting a building project would break ground without making sure they had enough cash to cover their costs. Understanding your company's **Cash Flow Statement** helps you steward this crucial asset. The Cash Flow Statement is especially important if your business uses accrual accounting to prepare the Balance Sheet. Accrual accounting means a company recognizes revenue when sales are made, before having the cash in hand. In this case, you could be in cash crisis and you wouldn't know it from looking at the Balance Sheet. The Cash Flow Statement, shows **cash coming in as positive amounts**, while **cash flowing out is shown in negative amounts** indicated by a negative sign, parentheses, and/or red ink.

THE CASH FLOW STATEMENT IS SPLIT INTO THREE AREAS:

CASH FLOW FROM OPERATING ACTIVITIES

- CASH FROM CUSTOMERS
- CASH PAID TO SUPPLIERS AND EMPLOYEES *(Negative)*
- INTEREST RECEIVED
- INTEREST PAID *(Negative)*
- TAX PAID *(Negative)*

CASH FLOW FROM INVESTING ACTIVITIES

- PURCHASE OF ADDITIONAL EQUIPMENT *(Negative)*
- REPLACEMENT OF EQUIPMENT *(Negative)*
- PROCEEDS FROM SALE OF EQUIPMENT

CASH FLOW FROM FINANCING ACTIVITIES

- PROCEEDS FROM CAPITAL CONTRIBUTED
- PROCEEDS FROM LOAN RECEIVED
- PAYMENT OF LOAN *(Negative)*

ACTION ITEM

Calculate your **Net Cash Flow from Operating Activities**.
Are you making money through your company's normal operations?

Calculate your **Net Cash Flow from Investing Activities**. Is your company in a heavy investment stage? Does your cash flow from investing match your company strategy?

Calculate your **Net Cash Flow from Financing Activities**
Is it bigger than your net cash from operating activities? If so, you are raising more money through equity than your business is generating on its own, something that makes sense in an expansions stage but not forever. Does your net cash from financing activities match your company strategy?

CONCLUSION: GOD KNOWS YOUR BUSINESS

According to **Daniel 2:22**, God knows all hidden things, and He wants to bring them into the light. When you scrutinize your financial statements and ratios, you're doing God's work. Even if you have a CFO or accountant, you are ultimately responsible for assessing your financial performance. It's part of good stewardship, and you can do it with God's help.

What areas do you need help from your peers today in better mastering these documents?

APPLICATIONS

1. Review your financial statements with your senior leadership team and determine the collective competency to understand and respond to the data in them.

2. If your current documents are unclear, inaccurate or provided infrequently, meet with your accountant to work out a better review strategy.

3. Recommended reading: *Understanding Financial Statements* (Ormiston), *Scaling Up* (Harnish), *Visual Finance* (Tsvetanov), *Financial Intelligence* (Berman, Knight & Case) and *The Basic Understanding of Financial Statements* (Skonieczny). Also, review previous C12 segments such as, *Recession Proofing & Managing Through Slowdowns*, *Planning in Uncertain Economic Times*, and *Long Term Tools* for related topics.

4. A great fable-styled book to read and discuss around the economic essentials of your operation is *The Goal* by Goldratt. Consider reading and discussing with your leadership team.

TO-DOS

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ANNOTATIONS

[1] The maxim, *"no margin, no mission,"* is accredited to Sister Irene Kraus, leader of the *Daughters of Charity National Health Care System*, a network of more than 80 faith-based hospitals across the U.S. She advocated that in order to fulfill their faith-based mission behind the facilites, *"the way to do it is to run institutions that are financially solid."*

[2] You can also request a Profit Cents benchmark report from your C12 Chair which will include current and trending comparative ratios for your NAICS code, region, size, or corporate entity type. For example, in 2016 single family home builders ($10-$50 million in revenue) had an average Current Ratio of 1.84 and Quick Ratio of 0.57; whereas, machine shops saw Current Ratios of 3.95 and Quick Ratios of 2.35; and the broad category of engineering services saw 2.7 and 2.38.