



Protecting Small Business from Financial Risk

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Protecting Small Business from Financial Risk

According to many leading business analysts, small businesses stand the best chance of jump starting the economy and getting the financial markets moving again. Small businesses – defined by The Small Business Act as a business concern “that is independently owned and operated and which is not dominant in its field of operation” – employ almost half of the private sector workforce in the U.S. and are responsible for 60 percent to 80 percent of net new jobs annually. Given the vital role small businesses will play in our nation’s economic recovery, a prudent and responsible approach to protecting company assets should not be underestimated.

Grand Planning Drives Cash Flow and Results

The key to preserving the businesses that entrepreneurs and executives have worked so hard to build is to plan appropriately for potentially problematic situations. Successful business planning typically falls into the following categories:

Cash Flow and Revenue Plan – By developing or refining a cash flow and revenue plan, business owners must think through their business model and how their products or service will perform in

a particular sector and market. This exercise helps owners give careful consideration to the internal and external forces that affect revenue, cash flow and profitability. Cash flow management tools are readily available through a certified public accountant or commercial banking officer.

Risk Management Plan – Through the risk management planning process, business owners and executives anticipate any type of risk, including financial, that could face the organization and how the risk will be dealt with. A good risk management plan will address three specific areas: 1) various risks that could occur, such as financial, natural or man-made disasters, or major equipment failures; 2) strategies to mitigate each risk, such as proper insurance coverage, adequate emergency supplies or vendor support; and 3) a set of step-by-step actions in the event a risk occurs.

Standard Operating Procedures Manual – Organizations benefit greatly from the development of a manual that outlines policies and procedures for various aspects of the business. Examples include an established set of parameters and guidelines for the purchase of goods and services, obtaining price and availability quotes, hiring (or firing) of employees and vendors, and expense approval and other factors to help keep costs under control.

Establishing policies and procedures for a company’s bookkeeping and accounting practices is also highly recommended for any business. These could include limiting the number of people with access to petty cash, dual signatures requirement on company checks, and having a second party review bank account and credit card activity on a regular basis.

Contingency Plan – A contingency plan helps businesses prepare for dealing with known and

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unknown circumstances that may arise. For example, does the business address how the company will handle the incapacitation of the owner or a top executive? Is the company prepared to handle a considerable increase in business in a short amount of time, such as the addition of a new client? What happens if the business does not obtain an expected infusion of cash? Tackling these issues now can save much heartache in the long term.

Financial Risks and Subsequent Controls

According to a recent report by the Association of Certified Fraud Examiners, small businesses are the most susceptible to financial risk through occupational fraud and abuse, such as payroll schemes, check tampering and inventory theft. The majority of business owners surveyed reported they do not have internal controls in place to prevent such activity, leading to a median loss of \$200,000 for businesses with less than 100 employees. Without proper controls in place, businesses large and small are left vulnerable to financial mismanagement and fraud that can severely hamper the company.

Case in point: In 2008, a Tualatin, Ore., woman pleaded guilty to embezzling more than \$200,000 dollars from her employer. The woman had served as the accounting manager for the firm and used her position to help herself to company funds.

How can fraudulent activity be prevented in a small business with limited resources and staff? It is well worth the time and energy expended to implement proper internal controls, and it should be a priority for any small business. There are several controls that can be put into place to reduce the likelihood

of fraud in the workplace. Business owners and executives should schedule a meeting with an accountant or possibly a fraud examiner to determine the best practices for their specific business and industry. Below is a list of possible considerations:

- Written company policies
- Employee training
- Dual signatures requirement
- Annual financial audit
- Inventory of business assets
- Employee background checks

Minding Cash Flow

Another key point of financial risk to consider is the interruption of cash flow. Business owners should identify short- and long-term strategies to maintain an appropriate flow of cash in and out of the business. In fact, a rolling 12-month cash flow budget can be critical to a company's success. Cash flow budgeting tools, as mentioned earlier, are readily available from your CPA or commercial banking officer.

In terms of cash flow management, businesses should assess revenue, expenses, and accounts payable and receivable. Is revenue adequate to meet fixed expenses? Is the business controlling fixed expenses and planning for the unexpected? How quickly is the business issuing invoices and collecting payments? Perhaps the business could start a rainy-day account or open a line of credit. It is always wise to review opportunities for streamlining operations or cutting unnecessary costs. Businesses may also consider negotiating long-term contracts for supplies or goods to lock in lower rates, or purchasing equipment, such as computers, in larger quantities for better pricing.

The majority of business owners surveyed reported they do not have internal controls in place to prevent fraud and abuse.

Small business owners should also schedule a meeting with their accountant and banker to discuss possible cash flow strategies; a business owner may overlook the obvious or be unaware of unique solutions. An honest, timely discussion with a third-party professional can prove invaluable to solving cash flow concerns.

Other Forms of Risk to Consider

When it comes to other forms of financial risk, all too often businesses operate under the “that will never happen here” mentality. But this mindset can lead to dire consequences.

Savvy small business owners and executives recognize that the cost of running their day-to-day operations can fluctuate greatly depending upon numerous conditions such as the failure of an essential piece of equipment, the unexpected price increase of raw materials, or the higher costs and expended resources to locate a new supplier. These and many other operational costs, such as staff turnover, business slow-downs, or nonpayment for products and services provided can lead to small enterprises facing financial hardship.

Natural and man-made disasters can also severely impact the finances of a company. Business owners

must consider scenarios such as a fire that destroys a warehouse containing products that clients have already paid for. Or a major storm which prevents employees from getting to work and serving customers.

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Case in point: In 2008, Seattle experienced a rare snowstorm that prevented thousands of people from reaching their places of employment. It also kept customers from getting to businesses such as dry cleaners, restaurants and doctors offices. In essence, the city shut down for several days and many local businesses experienced economic losses.

Conclusion

Many small-business owners find themselves in the quandary of not being protected against various types of risk, and not having the resources, time or knowledge to keep negative situations at bay. Many adverse occurrences could be prevented with proper planning and implementation of policies and procedures designed to protect the enterprise. From whatever source the risk may arise, it is in the best interest of the business owner, the business and its employees to invest in the proper protection of this vital component of the country’s economic engine.

Sources:

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“Planning for Contingencies,” Business Owner’s Toolkit Small Business Guide

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Pacific Continental Bank maintains a strong connection to the communities where we operate. The bank empowers its employees to actively engage in fostering an environment where all community members can flourish. We endeavor to work with local nonprofit organizations and community-based businesses, ensuring more dollars stay close to home. The bank supports hundreds of nonprofit organizations in achieving their missions – both philanthropically and through direct participation.

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