Managing Your Assets

Small Business Success Series
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Your business assets, that is anything your business owns, enable your business to deliver products and services. At the same time, they require capital to pay for them, creating a cash drain or debt that you must manage. To succeed in business, you want to have the assets you need, when you need them and when you can afford them. This bulletin highlights management techniques and tools used by business owners, regardless of the type of business you operate, to manage assets effectively.

What Are the Kinds of Assets?

Business assets include **tangible assets** and **intangible assets**.

Tangible assets are either fixed assets or current assets.

1. **Fixed assets** — These are resources you own that your business will use over a long period of time, usually longer than a year. Fixed assets include land, buildings, equipment, vehicles, furniture and fixtures as well as improvements to leased property or holdings.

2. **Current assets** — These are resources you own that you will use up over a shorter period of time, normally less than a year. Examples of current assets are cash on hand, accounts receivable, inventory and prepaid expenses.

Intangible assets include patents, research and development projects, customer lists and good will associated with your business name.

Different types of businesses will have a different mix of assets.

Different types of businesses will have a different mix of assets. Manufacturing firms may have a sizeable investment in land, buildings and equipment, while a retail business typically puts money into inventory. A service business can have tangible assets such vehicles and computers (fixed assets), products used to deliver services (current assets) and intangible assets such as a client list.

Managing Fixed Assets

Purchase Fixed Assets

Given the financial implications, purchasing fixed assets is a major management decision. Things to consider include:

a. Do I need the asset?
b. How will the new asset benefit my business?
c. How much will it cost and what is the cost benefit?
d. What is the financial impact on my business?
e. Should I buy new or used or should I lease?

a. Do I Need the Asset?

The challenge for businesspeople is determining whether an asset is *needed* for effective business operations or *nice to have* (a want). A new fixed asset must address a real need of the business and give you a positive return on its investment over the long term. It must provide benefits to your business that will enable it to grow or become more profitable. Once you establish a need, the obvious issues are:

- when can we afford to buy it?
- how will we pay for it?

b. How Will the New Asset Benefit My Business?

To justify purchasing assets, you want to determine if they will increase your profits by increasing sales or by reducing your costs. Benefits from new assets include greater operational efficiencies, better customer service, lower production costs, or higher production levels. For example, more efficient equipment might cut your power bill, trim your maintenance costs or boost staff productivity — any of which will increase your profits.

Ask yourself the following questions:
i. Will the new asset improve the efficiency, capacity and productivity of my business? By how much?
ii. Will the new asset increase my sales or reduce my costs over its projected life?
iii. Will the new asset allow my business to compete more effectively? How?
iv. Does the asset bring a long-time benefit or a short-term gain to my business?

c. How Much Will It Cost and What Are the Cost Benefits?

Before you purchase an asset, make sure all costs to make the asset operational are known. Additional costs may include installation charges, additional staff, training of operators, insurance, higher utility usage, supplies and tax implications.

Knowing the total costs to acquire the asset and the financial benefits of the asset over time, you can weigh the pros and cons to decide whether to purchase the asset.

> Knowing the total costs... you can weigh the pros and cons...

d. What is the Financial Impact on the Business?

You may need to finance the purchase of assets. This creates an additional drain on your cash flow and impacts business ratios such as your debt-to-equity ratio. A substantial increase in the debt load of your business may limit your ability to borrow money in the future for other business needs. Weigh these implications carefully against the value of the asset.

e. Should I Buy New or Used or Should I Lease?

Compare these options:

Option	Pros	Cons
1. Buy Used	• low initial purchase price • usually good selection • own and control the asset	• no warranty • may not have a long product life left • no help with installation and training
2. Buy New	• current technology • expert help for installation and staff training • easiest to finance • own and control the asset	• higher initial cost • may need to borrow to pay for the asset • may need to renovate building or update utilities • you can depreciate only a portion of cost of the asset, including half of the normal allowable rate in the year purchased
3. Lease	• low initial down payment • longer, flexible payment schedules • total lease payment tax deductible • lease does not impact debt/ equity ratio • access latest technology • test an asset before making a long-term purchase decision	• May not be able to use your domain name • Must conform to site policies • May require a commission on sales

About Buying Used

Buying used is a better decision for certain types of assets, such as furniture and fixtures or vehicles, where regular maintenance and repair can prolong their useful life. Purchased for less cost, used assets sometimes do not need to be state-of-the-art to be effective. An office desk, for example, can be functional without being pretty if customers and suppliers are never in your office.

About Leasing

Almost any business asset can be leased rather than purchased. Assets that are commonly leased include vehicles, office furniture, computer systems, communication devices, equipment and store fixtures. Leasing is often cost-effective for assets that decrease in value over time and have a useful life of less than five years. With assets to be used more than five years, the long-term cost of leasing may be more than purchasing the asset outright.

In order to decide whether to lease or to buy, you need to know the following:

- All the costs associated with the purchase or lease decision
- Purchase financing terms versus lease terms
- The asset's useful life and its value at the end of its useful life
- Expected maintenance costs and who pays
- Interest rates for borrowed money

Almost any business asset can be leased rather than purchased ...

Calculate Your Cost Benefit — Use a cash flow budget forecast to calculate the cost benefit for each option. This forecast will show additional sales and costs attributed to the asset over its useful life for each lease-or-buy alternative.

About Replacing Fixed Assets

When should you replace an asset? Assets eventually break down and start costing money to repair. Before deciding to repair or replace the asset, think about whether or not you still need this asset. Will a repaired, refurbished or replacement asset make your business more efficient, productive and profitable? If you decide there is still a need for the asset in the business, compare costs of repair of the existing asset against costs of a replacement.

Managing Inventory

Inventory is the goods — raw materials, parts or finished products — owned by your business at a given moment. For a retail business, inventory is probably its main asset. In a manufacturing business, inventory includes raw materials, work-in-progress and finished products waiting to be sold. Service firms may have inventory in materials necessary to provide service to customers.

Inventory is a cash investment for your business. When your inventory is financed, you also incur debt servicing costs. Too much investment in inventory reduces the amount of cash available for other purposes. Too much inventory also means wasted space, increased insurance costs and potential declining market value of unsold inventory.

For a retail business, inventory is probably its main asset.

Effective inventory management balances the costs of buying inventory with the benefits of holding the inventory. A fine line exists between having too much on hand and not having enough. For example, a business can get lower prices by buying in volume but risks ending up with too much product to sell.

Three ways to enhance inventory management include inventory monitoring, good inventory purchasing procedures and inventory control.

Monitoring Inventory

Cost of goods sold may be your largest expense. So, good planning and monitoring is essential. You want your inventory to be current and fresh because it sells relatively quickly. This scenario confirms you are offering what customers want.

Inventory Turnover is how many times you sell and replenish your stock in the course of a year. Low turnover can indicate poor buying that ties up cash that could be used for other purchases. A high turnover rate is usually good but you have to be careful that you're not carrying too little product. You don't want a reputation of always being out of stock. Compare your turnover rates with industry averages. Interview other business owners or contact your local business association to get this information. Statistics Canada also publishes average sales and expenses for various industries.

Analyzing turnover can also help you plan your promotional activities. For example, if you find you are not selling a line of product as quickly as you want, you can plan a sale or promote the product through an ad campaign.

To determine the turnover rate for your products, divide the cost of your annual sales by the cost of your average inventory on hand.

$$\text{Turnover Ratio} = \frac{\text{Cost of Annual Sales}}{\text{Cost of Average Inventory}}$$

Another monitoring tool is ***turnover analysis***, which focuses on individual products or groups of inventory items. This tool requires a physical inventory count of items. It compares the number sold in a month, the number on hand, and the desired number to be in stock. Using this tool, you can determine whether to reduce or increase specific inventory items. Some computer inventory control systems can perform this function for you.

Usually a small percentage of your products generate the majority of your sales. Identify which products fit this profile for your business to ensure you have enough inventory of fast-moving merchandise to minimize lost sales due to being out of stock.

Don't forget to establish the true costs of your inventory; hidden costs include storage, financing, carrying charges and declining market value of goods.

Buy Inventory

Key to effective inventory management is having items in stock just when they are required. Just-in-time inventory management minimizes inventory. In a manufacturing setting, for example, the inventory of raw materials and work-in-progress can be reduced to what is needed in a week if a very efficient supply system is in place.

Don't forget to establish the true costs of your inventory...

To reduce your inventory without narrowing product selection, stay attuned to customers' demands and buy goods early enough to ensure delivery at the right time. This requires planning.

Your purchasing plan should take the following into account:

1. **Inventory depletion** — Based on your recent sales experience and competitor activities, how long will the current inventory last?
2. **Seasonal variation** — What is the seasonality of your products? Do you expect to sell more in a particular month and less in others?
3. **New product purchases** — What is the market demand and competitors' actions related to new products?
4. **Volume buys** — How will volume price savings in bulk purchasing compare with realistic sales potential?

Your purchasing plan should also complement your promotions plan. Make sure you have the capacity to fill new orders as your promotions run throughout the year.

Control Inventory

Inventory controls can include the following:

1. **Visual control** — Make ordering decisions based on what you see needs replacement on your shelves.

2. **Price tag control** — A duplicate price tag placed on the product is retained when an item is sold to trigger re-ordering. Or price tags coded by date of arrival can be used to identify old stock to determine when the price should be discounted to clear items.

3. **Point-of-sale terminals** — These computer terminals collect and report each item sold. Managers can review reports generated to take necessary action. With reduced computer and software costs, it has become quite feasible for small businesses to use this technology approach.

Day-to-day inventory control is also important. Implement procedures such as counting and verifying items received and examining them for any damage. This can help reduce loss resulting from delivery problems.

Conclusion

Managing assets, including fixed assets and inventory is half of the cash flow equation for your business (sales and revenue being the other half). By managing your assets effectively, you will sharpen your business operations and improve your profits.

Other bulletins and guides in The Business Link's Small Business Success Series are available on-line at www.cbsc.org/alberta/SuccessSeries.cfm.

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