Mind Your Own Business

In this article we are going to discuss a horse business's *Chart of Accounts* related to *Equity*, and *Income* and *Expense*.

Equity is the ownership interest in a business and can be in the form of common stock or preferred stock. In the previous article we discussed *Assets* and *Liabilities*. *Assets* are what a business *owns*. *Liabilities* are what a business *owes*. *Equity* is what a business is *worth*. *Equity* is *Total Assets* minus *Total Liabilities*, in which case it is referred to as shareholder's equity, or net worth, or book value.

Expressed in an equation, *Equity* is:

$$\textbf{\textit{Equity = Assets - Liabilities}}$$

Equity in a horse business generally comes from the funds used to start the business, and additional funds put into the business after it is started, and retained earnings. Retained earnings are a business's net income (profits). If a business losses money the loss is subtracted from its *Equity*.

The *Chart of Accounts* for *Equity* should reflect the types of transactions that influence the ownership interest and how the owner's *Equity* is managed and measured. Possible accounts include: investments, withdrawals of cash by the owner, retained earnings, and income generated and expenses incurred by the business. *Income* generated and *Expenses* incurred are temporary '*accumulation accounts*' that are '*flushed*' at the end of an accounting period and show up back in the business's *Equity* as retained earnings.

The '*Debt to Equity*' ratio is a good indicator of a business's leverage as explained in the last article. For review purposes; The *Debt to Equity* formula is:

$$\textbf{\textit{Debt to Equity}} = \frac{\textbf{\textit{Total Liabilities}}}{\textbf{\textit{Shareholders Equity}}}$$

The *Debt to Equity* ratio measures the proportion of the total assets that are financed by stockholders and not creditors. . A ratio greater than 1 means assets are mainly financed with debt. A ratio less than 1 means assets are mainly financed with equity. A lower ratio means your business is more financially stable and is probably in a better position to borrow now and in the future. A low *Debt to Equity* ratio will produce good results for stockholders as long as the company earns a rate of *Return on Assets (ROA)* that is greater than the interest rate paid to creditors. Remember, if an *Asset* isn't producing and doesn't return an acceptable *Return on Investment (ROI)*, fix it or sell it.

The *Return on Assets* formula is:

$$\textbf{\textit{Return On Assets (ROA)}} = \frac{\textbf{\textit{Net Income}}}{\textbf{\textit{Total Assets}}}$$

The *Return on Investment* formula is:

$$\textbf{\textit{Return On Investment (ROI)}} = \frac{\textbf{\textit{(Gain from Investment – Cost of Investment)}}}{\textbf{\textit{Cost of Investment}}}$$

Income Accounts are accounts into which revenue (Sales) is collected and closed at the end of an accounting period. The resulting *Income* minus the *Expense* incurred generating the *Income* equals the *Profit* (*Loss)* of the business. The *Income Accounts* should reflect the sources of *Income* in your horse business. If you have multiple sources of income an account should be identified for each source so that source can be measured and managed. Potential Income accounts in a horse business include: Boarding, Training, Lessons, Breeding, Racing, Showing, etc. Although an *Income Account* may be a major category such as Training, a business should use a management system that allows it to define multiple subaccounts for different types of Training. Defining subaccounts lets a business measure the impact of a particular product or service on their business's *Income* and profitability. Spending time and money on an income source that is not profitable is not good business. If you have an income source that isn't profitable you have two choices; figure out why it isn't profitable and make it profitable, or eliminate it as a source of income and additional expense. Possible ways to improve your business's *Income* and profitability are:

- Increase sales (expand your market reach and customer base)
  - Differentiate your business from your competitors – exceptional customer service (free if done properly), offer more amenities with a minimal increase in expense, offer higher margin products and services, …
  - Advertise more – watch the expense
  - Increase your exposure in your market – club attendance, horse shows and events, …
- Raise prices (be careful, your still need to be competitive and product quality does have its limits)
- Reduce expenses (new suppliers, eliminate waste, establish purchasing procedures and limits, …

I cannot emphasize enough that in business it all starts with a sale and making a sale is generally the most difficult challenge in a business. It is a lot easier to manage expenses than it is to manage a customer. Make sure the *Income Accounts* you identify enable you to measure and manage your income sources. In a future article we will discuss '*Breakeven Analysis*' and how it applies to product or service pricing and sales strategies.

The greatest number of accounts identified in your *Chart of Accounts* is generally the accounts associated with *Expenses* incurred in the daily operation of your business. *Expense Accounts* should take into consideration non-capital expenses associated with generating *Income* and operating your business. Care should be taken to identify the accounts that reflect how you want to measure and manage your business expenses. Many *Expense Accounts* will need to be divided further into subaccounts so you can have the detail you need to manage your suppliers, reduce cost, improve quality, and optimize purchases, minimize inventory, minimize the use cash and many more expense related decisions. A good Horse Business Management System includes a complete list of horse related expense accounts and allows a business to define multiple subaccounts for each primary *Expense Account*.

In future articles we will setup and use a *Chart of Accounts* to explore how to manage and improve a horse business. I suggest you list all your sources of income in your horse business and then list all the expenses associated with each income source and the amount of time you spend managing each source. You may be surprised to discover that some of your sources of income take a lot of time and expense and really are not worth it. You may discover that other areas of your business can be improved and made more profitable by eliminating marginal activities and freeing up your time. You may also discover that it is alright to fire a '*high maintenance*' customer. Remember, spending your time and money wisely may provide the opportunity to enjoy your business more while making more money.

We have concluded the overview on how to set up a *Chart of Accounts*. We are now ready to use what we have learned to measure and manage a horse business. To be successful in a horse business does not require a finance education, but an understanding of what your financials are telling you will enable you to make better business decisions. A good horse business management system will do the calculations for you and analyze and report the results with comments or suggestions.

Think – plan – organize – execute – make/save money.

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