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Mueller Prost
CPAs + Business Advisors

Advising with Vision®

Business Owner's Perspectives

Trends and Strategies for Owners of Closely Held and Family Businesses

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Financial Strategies

Are You Budgeting for Replacement Capex?

Businesses today rely on all different kinds of equipment to keep operations running smoothly and meet customer expectations for on-time delivery of products and services.

This is true for not only equipment intensive businesses like manufacturing, distributors and construction firms but also some service businesses that require the latest new computers and software to meet client demands.

One of the biggest mistakes these businesses sometimes make is failing to plan ahead for replacement of such equipment. Neglecting to budget for replacement capital expenditures, or capex, can result in serious financial strains when the time eventually comes to upgrade critical business equipment.

Pay Now … or Later

Budgeting for replacement capex is kind of like the old commercial for Fram oil filters in which the auto mechanic says, "You can pay me now … or pay me later."

The question isn't whether or not equipment is eventually going to wear out or become obsolete and need replacing. It will. The question is how are you going to *pay* for new equipment when the time comes?

If you don't plan ahead and budget for replacement capex and you don't have enough liquid funds to pay for new equipment when the time comes, you must lease or finance the equipment. You will determine the amount of free cash flow after servicing existing debt to see how much financing you may qualify for.

And remember: You may or may not qualify for the financing needed to replace or upgrade all the equipment that needs it.

Capex budgeting is critical for any company that uses equipment.

It's important to note that leasing or financing equipment isn't necessarily a bad thing —in some instances, it's preferable to paying cash. But failing to plan ahead and budget for replacement capex severely limits your options when it comes to acquiring new equipment in the future.

Build a Reserve Fund

One strategy is to build a reserve or sinking fund for replacement capex. This fund should be equal to your annual depreciation expense, at a minimum. Here's an example of how this might work for a construction company with a fleet of 10 cement mixing trucks:

The owner of the business plans on replacing two trucks every year at a cost of $150,000 per truck, or $300,000 total. To ensure that there is sufficient cash on hand to buy the trucks a year from now, the business would need to set aside $25,000 per month in reserve for the next 12 months.

If the business continues to save this every month in a sinking fund, it will be able to replace its two oldest trucks every year debt-free. As a result, no truck in its fleet will ever be more than five years old. This will help the business save money on repair and maintenance costs while minimizing downtime and keeping its fleet up to date from a technology perspective.

This strategy will give the business a tremendous amount of financial flexibility when it comes time to replace aging and obsolete trucks. For example, it can buy the trucks outright in cash or use the reserve funds to put a substantial down payment on the trucks and finance the remainder. This would help ease demands on monthly working capital and improve cash flow.

A Critical Exercise

Capex budgeting is a critical exercise for any company that uses equipment in the normal course of business. If you haven't budgeted for replacement capex in the past, resolve to do so starting now.

We can help you budget for replacement capex. Give us a call to discuss your situation in more detail.

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Word to the Wise

Done a SWOT? Now Try a PEST Analysis

You've likely heard of a SWOT analysis — a powerful business tool used to identify a company's Strengths, Weaknesses, Opportunities and Threats. But many business owners are now talking about a different kind of analysis to assess "big picture" factors impacting their companies.

Referred to as a PEST analysis — which stands for Political, Economic, Social and Technology — this exercise looks at external factors that can affect your business in a significant way.

For example, if you are considering launching a new product or service, entering a new market, or investing in new technology or equipment, PEST factors will likely reflect on the soundness, timing or financing of these decisions.

Tackling the PESTs

Bringing the PEST factors into focus allows you to identify trends in areas beyond your control. It can guide you in adapting your business to accommodate external agents of change.

You'll start by gathering information about the current and future factors that might affect your business. Next, brainstorm the impact of each factor to identify opportunities, threats and other issues arising from them so you can take appropriate action.

Your PEST analysis should look specifically at the following areas:

Political: This factor includes the governmental and legal circumstances relevant to your business climate. For example, how stable is the current government and what kinds of leaders are on the horizon? Are there business or trade regulations, legislation or tax policies that are likely to impact your company — either in your favor or to your detriment?

Concrete examples of political impacts might include new regulations, deregulation or import restrictions; OSHA or EPA laws; union or trade agreements; and tax policies, tariffs or e-commerce regulations.

Economic: Here you want to follow the money. For example, is the economy growing, shrinking or stagnant? Are your customers likely to spend more or less in the future? Are employment, inflation and interest rates working to your advantage or disadvantage? How easy is it for you, your suppliers and your customers to access financing?

Examples of these impacts include labor costs, exchange rates, stock market trends, disposable income, and even weather or climate change.

Social: This factor will help you gain insight into customer behavior and market size. For example, are demographics and generational trends working for or against you? Is your market socially mobile? Are customers becoming more educated or more safety or health conscious and are they more focused on environmental issues? Are your buyers' attitudes changing relative to saving vs. spending or working vs. relaxing?

Examples of social impacts include your customers' age distribution, career and family stage; ethnic and religious considerations; major events and influences; media opinions and views; and buying patterns.

Technology: This factor will help you get a handle on how technological advances will impact your business and your plans for the future. For example, what role will the internet and the cloud play? Will research and development be a major influence in your industry?

For example, is your business involved in or influenced by changes in intellectual property, patents and licensing? Are there new technologies that you could or should be using? Is your industry technologically mature and thus ripe for an innovation overhaul?

Taking Action

Once you've identified the changes taking place in these areas, develop a plan for how you can take advantage of the opportunities while avoiding or mitigating the threats.

Depending on your business model and structure, this endeavor might require a team to tackle each area. Don't hesitate to call on outside resources for input. Trade organizations, government representatives, suppliers and customers may have valuable input based on their spheres of knowledge.

We can help you determine how the PESTs might impact your business. Call us to discuss next steps.

Talking Technology

How to Keep Your Business on the Cutting Edge

Sometimes, business owners can be hesitant to upgrade to the latest new technology, even if it would increase efficiency and improve profits. Call it the old "if it ain't broke, don't fix it" mindset.

But failing to implement and utilize new technology can be shortsighted and dangerous. Companies that don't stay on the technology cutting edge can quickly find themselves at a competitive disadvantage in the marketplace. If technology upgrades are neglected for too long, companies may fall too far behind to recover.

Efficiency and Automation Boost

Many technology tools are designed to help businesses increase efficiency by automating manual tasks. Accounting software is a good example — the latest programs enable automated reading, coding and allocation of invoices and receipts. This reduces the chance of errors, boosts accounting efficiency, lowers costs and eliminates processing delays.

Some pundits believe that we're nearing the point of "no-code accounting" in which manual data entry is no longer required. In this environment, automation and cloud accounting ecosystems eliminate the need for data entry. According to one industry estimate, cloud accounting software can automate between 80 percent and 90 percent of transactions that have traditionally been done manually.

Artificial intelligence, or AI, is big part of this. While the Hollywood version of AI conjures up images of intelligent robots plotting to overthrow mankind, AI is really nothing more than machine learning that recognizes patterns and applies this recognition to solve problems.

In the future, AI could be applied to general ledger applications to analyze pending and historical transactions and thus predict future cash flow without the use of spreadsheets. Or it could analyze sales trends and suggest inventory purchases that help businesses maintain optimal inventory levels. The possibilities of automation and AI in business accounting are practically limitless.

Moving to the Cloud

The move to the cloud is a big part of many technology upgrades designed to improve business efficiency. Subscription-based cloud services like software as a service (or SAAS) help level the competitive playing field for small and mid-sized firms by providing them with access to advanced technologies that were previously only available to large corporations.

Mission-critical applications like customer relationship management (CRM), enterprise resource planning (ERP), and project and document management solutions are now readily available via the cloud. By taking advantage of cloud-based applications like these, your business can utilize the technology solutions you actually need without spending money on technology you don't need.

Before the cloud, taking advantage of the latest and greatest business technology usually required investing in on-premises technology solutions. This meant buying servers, routers, software and hard drives and installing and maintaining them on your business premises.

Not only is this model expensive and inflexible, but it's also not scalable. When business technology is accessed via the cloud instead, employees can access it anywhere, at any time and on any device. The result is greater efficiency and productivity, lower IT costs and improved operational agility.

Don't Fall Behind

In today's competitive environment, your business can't afford to fall behind the technology curve. So make a commitment now to implement the latest tech tools needed to keep your business on the technology cutting edge.

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Should You Purchase a Cyber Insurance Policy?

After last year's massive data breach, the name Equifax will forever be linked with poor data security. This regrettable event exposed the personal financial information of 143 million consumers, many of whom have already been defrauded.

Your company may not be storing as much sensitive information as Equifax, but you probably hold some. While many smaller businesses believe they are unlikely to face a data hack, the 2016 State of SMB Cybersecurity Report says that hackers have breached half of all small businesses in the United States.

It's not just professional hackers that put your company at risk, either. Your employees' honest mistakes can easily expose sensitive customer or employee data. Or an employee's laptop could be stolen, along with the confidential account numbers or personnel files it contains.

In addition, if you accept credit or debit cards as payment, your customer data can be compromised via a point-of-sale vendor's system glitch or breach.

With these risks in mind, it might be smart to consider adding cyber insurance to your insurance portfolio. This is a liability insurance policy that protects your company in case of a data breach involving personally identifying information such as credit card and account numbers, driver's license numbers, Social Security numbers and health records.

Cyber insurance generally covers legal fees and expenses associated with a cyber attack, such as the cost of notifying your customers. It can also cover the cost of credit monitoring, identity recovery and credit history restoration services for affected customers.

Some cyber insurance policies also cover the cost of consulting or forensic analysis to investigate the cause of a breach, as well as public relations to assist with your company's reputation management.

All cyber insurance policies are not equal, though. So carefully investigate coverage, limits, deductibles and exclusions to be sure that you're getting the protection your company needs.