

Your small business financial health checklist



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Small business ownership comes with its fair share of challenges. Amid the daily demands of running your company—from managing employees to serving customers—it's easy to lose sight of the financial health that underpins your operations.

However, a clear understanding of your finances is critical. It helps you make informed decisions, navigate economic uncertainties and capitalize on opportunities for growth.

Learning to manage your finances effectively is like a financial checkup for your business. It gives you a chance to review your operations and learn more about strengths, weaknesses and potential areas of improvement. By proactively managing your business's financial well-being, you can take control and see its full potential.

Here are some key indicators that paint a picture of a company's finances.

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Cash flow analysis is the foundation for understanding your business's financial well-being.

How to do a cash flow analysis

A cash flow analysis helps track your business's inflow and outflow of money. It provides a real-time snapshot of your financial liquidity, highlighting whether you have enough small business cash flow to cover expenses, invest in growth and weather unexpected challenges.

Start by categorizing your cash inflows (revenue from sales, investments and loans) and outflows (expenses like salary, rent and inventory). Then, track these flows over a specific period—typically monthly or quarterly. This helps you identify trends, anticipate potential shortfalls and make better decisions about your spending and revenue generation strategies.

Tools for tracking financial health

Fortunately, there are plenty of tools to help simplify financial tracking and that offer valuable insights into your cash flow.

Here are three types to consider:

1. Accounting software: Popular options help automate bookkeeping tasks, generate financial statements and track expenses, making cash flow analysis straightforward.
2. Budgeting tools: These tools help you create and stay within a budget, ensuring your spending aligns with your financial goals.
3. Financial dashboards: Dashboards are visual tools that collect and consolidate financial data from various sources, offering a comprehensive overview of your business's financial performance.

Consider leveraging these kinds of tools to help stay on top of finances and make it easy to consistently monitor your small business cash flow.¹

Key performance indicators for small business financial health

Beyond cash flow, several other key performance indicators (KPIs) offer valuable insights into your business's financial health. These metrics provide a more nuanced understanding of your company's performance, allowing you to identify strengths, potential red flags and areas of opportunity.

Here are some of the most critical small business KPIs to watch:

Working capital

Working capital is the lifeblood of your day-to-day operations. It represents the funds available to cover short-term obligations, such as paying suppliers, employees and rent. Maintaining enough small business working capital to cover your needs ensures smooth operations and more flexibility in meeting financial commitments. Lines of credit can help you manage short-term gaps in revenue to ensure you have sufficient working capital on hand to run your business.

A positive small business working capital means you have the funds to cover your immediate needs, while a negative one signals potential cash flow issues.

Financial solvency

Working capital focuses on the short term. Your financial status, or solvency, assesses your business's long-term financial stability. It measures your ability to meet your financial obligations, both short and long-term. A solvent business has enough assets to cover debts, even if there are unexpected challenges.

A high solvency ratio indicates stability; the company has more equity than debt as well as the funds to cover any future financial needs.

Operating efficiency

Operating efficiency measures how effectively you use the company's resources to generate revenue. A higher operating efficiency translates to lower costs and improved profitability.

Key metrics around operating efficiency offer insights into your company's health. By monitoring these metrics, you can identify areas to streamline operations and reduce waste to boost your bottom line.

Other essential small business KPIs

In addition to the KPIs above, there are some other metrics small business owners may want to pay attention to. These include:

- Gross profit margin: This measures the profitability of your operations after accounting for the direct costs of goods sold.
- Net profit margin: This indicates the overall profitability of your business after deducting all expenses, such as wages or rent.
- Return on investment (ROI): ROI evaluates the efficiency of your business investments (such as new equipment) by comparing the gains from your investment to its cost.

Tracking these and other relevant small business KPIs can help you gain a comprehensive understanding of your financial performance, spot potential red flags and identify areas for improvement.

Reviewing your financial performance

You've begun tracking your financial health checklist through cash flow analysis and KPIs. The next stage is interpreting the results. Analyzing these results lets you know whether it is performing as expected, exceeding expectations or falling short.

Here are a few scenarios to consider with each situation:

If your business is meeting expectations

Meeting your financial projections and goals can be a good indication that your business is on the right track. It shows that your strategies are effective and operations are running smoothly. However, it's essential not to be complacent. Keeping your business on the right path and maintaining its financial health needs ongoing attention.

Here are a few tips to help ensure continued success:

- Fine-tune your strategies: Analyze your financial data to identify areas for optimization. Look for opportunities to increase efficiency, reduce costs, and boost revenue.
- Reinvest in your business: Allocate resources to goals that drive future growth, such as marketing, employee development or technology updates.
- Build resilience: Even when things are going well, prepare for potential challenges. Build a healthy cash reserve, diversify revenue streams where you can and stay aware of industry trends.
- Stay informed: Monitor economic conditions and market developments that could impact your business closely, and adjust your strategies as needed.

You've succeeded in managing your business so far; continue to watch for potential red flags and areas of improvement.

Exceeding financial expectations

Every small business owner looks forward to exceeding financial expectations. Current success can help you build a path toward more growth, so use this opportunity to further strengthen your company's financial foundation.

Here are a few suggestions on how to capitalize on positive performance:

- Invest in growth: Allocate resources towards expanding your operations, developing new products or services or entering new markets.
- Build a financial cushion: Set aside a portion of your profits to create a business emergency fund that can provide cash flow and help safeguard your business against unexpected events.
- Reward your team: To boost company morale, recognize employees' contributions by offering bonuses, profit-sharing or other incentives.
- Optimize your tax strategy: Consult with a tax professional to ensure you're taking advantage of all available tax deductions and credits.

Sustained success requires ongoing monitoring and strategic planning. Proactively managing your finances and capitalizing on opportunities helps drive continued growth for your business.

If your business is not performing as well as you would like

It's never a good feeling to discover your business isn't performing as well as you anticipated. However, challenges are a natural part of business ownership. The key is to identify the root causes and take action.

Potential reasons for underperformance could include:

- Declining sales or revenue: This could be due to changes in the market, increased competition or ineffective marketing strategies.
- Rising expenses: Unexpected costs, inefficient operations or poor expense management can eat into profits.
- Inadequate working capital: Insufficient funds to cover short-term obligations can hinder your ability to operate smoothly.
- High debt: Excessive debt can strain your cash flow and limit financial flexibility.

If you've identified these as areas of underperformance, consider some of the following to help improve your company's finances:

- Analyze your expenses: Review spending habits and identify areas where you can cut costs, without compromising quality or service.
- Boost revenue: Explore new marketing channels, expand your product or service offerings or implement pricing strategies to increase sales.
- Seek professional advice: Consult with a financial advisor, accountant, or small business banker to get expert insight into your business and a plan for getting back on track.

Facing financial challenges head-on and proactive planning can help stabilize the business.

Build a resilient business

Understanding and actively managing your company's financial health isn't just a one-time task—it's an ongoing commitment. Regularly assessing your cash flow, tracking key performance indicators and making informed decisions based on your financial performance can help you navigate challenges and stay on the path toward long-term success.

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