Small adjustments to your business can make all the difference when improving your profitability. It can also help keep the cash flowing when economic conditions are tough.

This guide has been designed to help you take a step back and understand your business’s finances better – allowing you to spot problems before they become too serious.
We have divided ‘Helping you assess your business performance’ into two sections:

Section One covers ratios any business should keep a close eye on:

1. **Profitability** – measuring your income against costs.
2. **Efficiency** – measuring whether your business is using its assets as well as it can.
3. **Liquidity** – how your assets measure up against your liabilities.

Ratios relate one number to another, and are usually – but not always – expressed as a percentage. Each topic in the first section covers a different business area but is laid out in the same way, step by step:

**Step 1:** Overview of how the ratio works.

**Step 2:** Shows you how to calculate the ratio.

**Step 3:** Allows you to reflect on your business’s performance.

**Step 4:** If your business figures have changed, this step will help you to identify the reasons ‘why’.

**Step 5:** Covers the benefits of improving particular aspects of your business.

**Step 6:** Balances any benefits against the ease of making changes to your business.

Section Two looks at ‘key success factors’ with top tips to help keep you on track during challenging economic conditions.

At the back you’ll find an action plan, which you can fill in using the results from the ratios, put into practice, and see how your business responds.

We’ll start by looking at gross profit margin, describing each of the above steps in detail and you’ll be able to pick and choose the ratios that are relevant for your business.
1. Profitability.

Your gross profit margin.

Step 1: What does it show?

Your gross profit margin (GPM) shows you the percentage contribution each sale makes towards profits before taking off overhead costs. Overhead costs are those costs which you would have to pay regardless of how much business you did, for example, rent, rates, professional fees etc.

Step 2: How do I calculate it?

GPM is calculated by dividing gross profit (sales less the direct costs of producing the goods or services supplied, for example, purchase of raw materials, assembly costs, etc.) by annual sales (turnover, excluding VAT), and multiplying the result by 100 to work out the change as a percentage.

Step 3: How is my business doing?

Using your past financial figures, you can calculate your gross profit margin for each year over the last three years at least (depending on how much information you have) – so you can judge how the ratio is changing.

Note: If you’re a start-up business or have been in business for less than a year, you can skip this step. However, historical information on your business will be very valuable to you over the next few years, so make sure you keep your financial records in good order. If your business is less than three years old – just calculate the ratios as far back as you can.

Use the table below to record your results (where value is your margin).

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<thead>
<tr>
<th>Value three years ago</th>
<th>Value two years ago</th>
<th>Value one year ago</th>
<th>Current value</th>
<th>Trend</th>
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</table>

Keeping in mind any seasonal fluctuations in your business, can you see any evidence for a trend? Rate it in the box above labelled ‘Trend’, using the following system where:

+ + means improving significantly
+ means improving
0 means no change
– means worsening
– – means worsening significantly.

Step 4: Why might the ratio be changing?

In this section we’ve provided some examples of reasons why your gross profit margin might have changed over time.

Increase in value:

• You have increased your selling prices.
• You have been able to obtain your raw materials at a lower price or at least the price these have gone up by is lower than the increase in prices you have made.
• There is less waste in your production process.

Reduction in value:

• You have had to reduce your prices.
• Your direct costs have increased and you have not been able to pass all this increase onto your customers.
• You suffer from stock losses due to the deterioration of stock, poor stock control or stock becoming obsolete.
Tips for improving your gross profit margin:

- Can you increase your prices at all? Even a very small increase can make a positive difference to your bottom line.
- Can you reduce your direct costs at all? Have you checked out other suppliers recently to see if they can do you a better all-round deal?
- Are there some products that bring a higher margin than others? If so can you focus more on these?

Record below any reasons you identify for a deteriorating trend or thoughts around how you might improve your gross profit margin.

**Note:** You don’t have to fill in all lines, and you can come back to them later on.

| 1. |
| 2. |
| 3. |
| 4. |
| 5. |

**Step 5: What is the benefit of improving gross profit margin?**

Improving your gross profit margin, while at the same time keeping your sales steady, will boost your profit. You can calculate the improvement in profit as follows:

Annual sales (turnover) (excluding VAT) multiplied by improvement in gross profit margin.

**Annual sales x increase in gross profit margin**

For example, if you could improve your gross profit margin from say, 22% to 23% and your sales are £200,000, then the additional 1% would give you £2,000 additional profit.

**Step 6: Is this worthwhile or possible for me?**

This final section helps you consider the balance between the benefit of improving business performance in this area, against how easy it will be to make that improvement.

Rate the benefit that it would make to your business if you could improve the performance of its gross profit margin. If, for example, your business is below average in this area, what would be the benefit if you could move to average? On a scale of 1 to 9, how would you rate the resulting benefit to your business?

- 1 means there would be no benefit at all.
- 5 means it would be worthwhile to do, but not that important.
- 9 means there would be a big benefit to your business.

Write your answer in the box on page 5 marked ‘benefit’.

Once you’ve done this, think about what changes your business would have to make to improve its performance in this area. For example, ‘I need to find new customers’. Then, record these changes in the line below.

**Note:** Once again, not all the lines need to be filled in. They are provided in case you identify numerous changes that you could potentially make to improve your business.

| a. |
| b. |
| c. |
| d. |
| e. |
On a scale of 1 to 9, how easy would it be to make the changes recorded overall?

- 1 means almost impossible.
- 5 means not that hard, but not that easy either.
- 9 means very easy.

Write your answer in the box below labelled ‘ease’.

‘Benefit’ of improving my gross profit margin? [score 1-9]  
‘Ease’ of improving my gross profit margin? [score 1-9]  
Your overheads vs your sales.

**Step 1: What does it show?**

This shows you the proportion of money from each sale that goes towards covering your overhead (or fixed) costs including interest and salaries.

Overhead expenses are those costs which should remain relatively fixed regardless of how much you sell, for example, rent or professional fees. They will only stay relatively fixed because they’ll probably increase as your business grows, for example, you might need to take on more staff or upgrade your premises as you expand. That said, overhead costs should not increase alongside sales in the same way that direct costs like raw materials do.

Any increase in overheads reduces your bottom line profit so you should keep a close eye on every expense and look to reduce it where possible. The trick here is often to look at your overhead expenses line by line if there is a problem, to identify exactly which costs are the issue so you can focus on them.

**Step 2: How do I calculate it?**

Overheads vs sales is calculated by dividing total overheads (total overheads, including all interest payments, salaries or drawings – the money you or your partners take out of the business, but excluding tax) by annual sales (excluding VAT) multiplied by 100.

**Step 3: How is my business doing?**

Use the tables below to record your results.

<table>
<thead>
<tr>
<th>Value three years ago</th>
<th>Value two years ago</th>
<th>Value one year ago</th>
<th>Current value</th>
<th>Trend</th>
</tr>
</thead>
</table>

**Step 4: Why might the ratio be changing?**

**Increase in value:**
- Your overheads (costs that do not change proportionally as sales increase or decrease, for example rent) have not increased as fast as your sales.
- Your interest costs are lower.
- Your gross profit margin has improved.

**Reduction in value:**
- Your overhead costs have increased faster than your sales.
- You are borrowing more so your interest costs are higher.
- Your gross profit margin has declined.

**Tips for improving your overheads vs sales margin:**

- Examine your overhead costs line by line. Are there some which have gone up more than others? Or some that you might be able to reduce?
- Could you find new suppliers for some of your overheads? For example, have you looked at changing utility suppliers recently and worked out how much you might be able to save?
- Are there some costs you should be looking to increase? For example, could spending a little more on really effective marketing increase sales sufficiently to cover the additional expense?
- A quick way to calculate the extra sales you need to cover additional overhead costs is to divide the extra cost by your gross profit margin. For example, if you are going to spend £5,000 on new marketing and your gross profit margin is 30%, you’ll need to generate at least £17,036 extra sales to cover the cost.
Record below any reasons you identify for a deteriorating trend or thoughts around how you might improve your net profit margin. You may come back to these later on.

1. 
2. 
3. 
4. 
5. 

**Step 5: What is the benefit to me of improving this?**

This is a simple calculation: every penny you can save on your overhead costs adds directly to your bottom line profit. This calculation can help you think how to work smarter not harder, especially important in times of economic difficulty when sales might be hard to come by. If you can reduce overhead costs then it is almost like you are making extra sales (as you are generating more profit without the need to do all the hard work involved in selling and then making or delivering your product or service. This can be calculated as follows:

| Reduction in overheads | Gross profit margin % |

This figure is the same as the equivalent value of sales to make this extra profit.

**Step 6: Is this worthwhile or possible for me?**

Record below any changes your business would have to make to improve its performance in this area.

a. 

b. 

c. 

d. 

e. 

‘Benefit’ of improving my overheads vs sales? (score 1-9) [ ]

‘Ease’ of improving my overheads vs sales? (score 1-9) [ ]
Section 1

2. Efficiency.

Your average collection period (debtor days).

Step 1: What does it show?
Your average collection period is the average number of days it takes you to collect money owed to you by your debtors i.e. your receivables.

Step 2: How do I calculate it?
Average collection period is calculated by dividing the amount of money you are owed by your debtors by your annual sales (turnover, exclusive of VAT) and multiplying the result by 365.

\[
\frac{\text{Money owned by debtors}}{\text{Annual sales}} \times 365
\]

Step 3: How is my business doing?
Use the table below to record your results.

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<thead>
<tr>
<th>Value three years ago</th>
<th>Value two years ago</th>
<th>Value one year ago</th>
<th>Current value</th>
<th>Trend</th>
</tr>
</thead>
</table>

Step 4: Why might the ratio be changing?

Reduction in value:
- You’re even more effective at chasing up your debtors.
- You offer discounts for early payment.
- You changed the terms of trade to reduce the period of credit you offer.

Increase in value:
- You have one or two large debts that are long overdue.
- You do not issue your invoices as promptly.
- You are finding it more difficult chasing debtors.

Tips for improving your average collection period:
- Don’t be afraid to ask for money you are owed.
- Issue invoices promptly, don’t wait for month end.
- Phone to check that the invoice has been received, and that your customer is happy with your goods/service.
- Carry out regular credit checks on the companies you are doing large deals with.

Record below any reasons you identify for a deteriorating trend or thoughts around how you might improve your average collection period.

1.
2.
3.
4.
5.
Step 5: What is the benefit to me of improving this?

Some businesses do not chase their debtors too hard, as they are afraid of losing their custom in the long run. But keep in mind there are considerable benefits to making sure you collect your debts as quickly as possible, as this will reduce the likelihood of you suffering from any bad debts, and, just as with stock turnover (see page 12), this will release cash into your business. The cash released can be calculated in the same way as for stock turnover, namely:

Multiply the improvement in average collection by annual sales (exclusive of VAT). Divide the result by 365 to show the average amount by which you may be able to reduce your bank overdraft or increase your cash deposits by.

| Number of days by which collection period can be improved | $\times$ annual sales | $\frac{365}{365}$ |

Step 6: Is this worthwhile or possible for me?

Record below any changes your business would have to make to improve its performance in this area.

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<td>e.</td>
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</table>

'Benefit' of improving my average collection period? (score 1-9) ☐

'Ease' of improving my average collection period? (score 1-9) ☐
Your average credit period (creditor days).

**Step 1: What does it show?**

Your average credit period is the average number of days it takes you to pay your trade creditors/payables.

**Step 2: How do I calculate it?**

Average credit period is calculated by dividing the amount you owe your trade creditors by your purchases and multiply the result by 365.

\[
\text{Creditors} \div \text{Purchases} \times 365
\]

**Step 3: How is my business doing?**

Use the table below to record your results.

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<thead>
<tr>
<th>Value three years ago</th>
<th>Value two years ago</th>
<th>Value one year ago</th>
<th>Current value</th>
<th>Trend</th>
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</thead>
</table>

**Step 4: Why might the ratio be changing?**

**Increase in value:**
- You have negotiated better terms from your suppliers.
- Your cash flow is very tight so you cannot always pay your creditors on time.

**Reduction in value:**
- Your suppliers have become able to dictate their terms to you.
- You no longer take advantage of discounts when paying early.

**Tips for improving your average credit period:**
- If cash flow is tight, see if you can negotiate longer terms.
- Keep your cash flow forecast up to date. If you spot any problems, talk to your bank early about increasing your facilities.

Record below any reasons you identify for a deteriorating trend or thoughts around how you might improve your average collection period.

1. 
2. 
3. 
4. 
5.
**Step 5: What is the benefit to me of improving this?**

The benefit of improving this ratio is not easy to quantify. For example, if you take more credit from your suppliers, then this would release cash into your business in the same way that stock turnover does (see page 12) (the calculation would be the same but using the additional days credit you take).

However, it may actually be worth you taking less credit. For example, if your suppliers offer discounts for early payment, and you have enough spare cash to take advantage of these then as a general rule you should do so. The additional profit from the reduced price you pay will normally far outweigh the benefit of holding on to your cash for a few more weeks. Alternatively, you may be able to negotiate a better price if you can pay quicker.

**Step 6: Is this worthwhile or possible for me?**

Record below any changes your business would have to make to improve its performance in this area.

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<tr>
<td>a.</td>
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</table>

'Benefit' of improving my average credit period? (score 1-9)  
Ease' of improving my average credit period? (score 1-9)
Your stock turnover.

**Step 1: What does it show?**

Your stock turnover shows how quickly you turn your stock into sales. For most businesses, it is preferable to have a rapid turnover of stock so that wastage is minimised and the amount of money tied up in stock is kept as small as possible. A high performer in this ratio will turn their stock into sales in the lowest number of days.

**Step 2: How do I calculate it?**

Stock turnover is calculated by dividing total cost of goods sold by the stock value (exclusive of VAT for the last 12 months).

<table>
<thead>
<tr>
<th>Cost of goods sold</th>
<th>Stock value</th>
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</table>

**Step 3: How is my business doing?**

Use the table below to record your results.

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<th>Value one year ago</th>
<th>Current value</th>
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</table>

**Step 4: Why might the ratio be changing?**

**Reduction in value:**
- You have started to manage your stock more efficiently.
- You have started a 'just in time' system with your suppliers.

**Increase in value:**
- You have too much stock, some of which you are finding difficult to sell.
- Not all of the stock you have included is saleable any more.
- You have bulk bought stock which you have not yet sold.

**Tips for improving your stock turnover:**
- Introduce a 'just in time' ordering system to minimise the amount of stock you hold.
- Sell 'dead' stock for any amount you can get – making a 50% loss on old stock is better than making a 100% loss.
- Bulk buy stock for better deals if you know you can sell it.

Record below any reasons you identify for a deteriorating trend or thoughts around how you might improve your average collection period.

1.
2.
3.
4.
5.
Step 5: What is the benefit to me of improving this?

There are clear benefits to reducing stock holdings, as this will reduce the space required for storage and also minimise loss from deterioration of stock, wastage and stock becoming obsolete. There is also a benefit as there will be less money tied up in stock. This could enable you to reduce your bank borrowing or have some more spare cash. This benefit can be quantified as follows:

Take the number of days by which you can improve your stock turnover and multiply this by your annual sales (exclusive of VAT). Divide the result by 365. This gives you the amount of cash you would effectively release.

Number of days by which stock turnover can be improved \( \times \) annual sales

\[
\frac{\text{Number of days by which stock turnover can be improved}}{365} \times \text{annual sales}
\]

For example, if your annual sales are £100,000 and you can reduce your stock turnover from 50 to 35 days, then the calculation is:

£100,000 (sales) multiplied by 15 (improvement in stock turnover) = £1,500,000. Divide this by 365. The cash released is £4,109.

If your business is always overdrawn, you could reduce your average overdraft by this amount.

Step 6: Is this worthwhile or possible for me?

Record below any changes your business would have to make to improve its performance in this area.

<table>
<thead>
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</tbody>
</table>

‘Benefit’ of improving my stock turnover? (score 1-9)

‘Ease’ of improving my stock turnover? (score 1-9)
Section 1

3. Liquidity.

The next two ratios (current and quick ratios) are useful for many, but not all businesses. Businesses with a relatively low turnover may want to miss these ratios, and move on to the key success factors.

Current ratio.

**Step 1: What does it show?**

Your current ratio means your ability to pay bills that are due in the immediate future. This is also known as your liquidity ratio or your working capital ratio.

**Step 2: How do I calculate it?**

Your current ratio is calculated by taking the total of your current assets (debtors due in the next 12 months, stock, cash etc.) and dividing this by the total of your current liabilities (payments due in the next 12 months, bank overdraft, etc.).

\[
\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}
\]

**Step 3: How is my business doing?**

Use the table below to record your results.

<table>
<thead>
<tr>
<th>Value three years ago</th>
<th>Value two years ago</th>
<th>Value one year ago</th>
<th>Current value</th>
<th>Trend</th>
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</table>

**Step 4: Why might the ratio be changing?**

**Increase in value:**

- You have more spare cash than previously.
- You have excess cash tied up in stock or debtors.

**Reduction in value:**

- You have increased your borrowing.
- Your business is not retaining as much profit.

**Tips for improving your current ratio:**

- Sell any unused property and equipment.
- Renegotiate short-term debt to long-term financing

Record below any reasons you identify for a deteriorating trend or thoughts around how you might improve your average collection period.

1. 
2. 
3. 
4. 
5. 
Step 5: What is the benefit to me of improving this?

Clearly it is important to have enough money to pay your debts. Simply, the higher the ratio, the more secure your business should be, as you will be able to meet your debts as and when they are due. A higher ratio also means your business has a ‘safety net’ if, for example, you suffer a bad debt.

It is also important to understand the reasons for your business’s current ratio. For example, a higher ratio than average may look good at first glance, but this would not be true if it was higher due to unsaleable stock still being counted as an asset.

Step 6: Is this worthwhile or possible for me?

Record below any changes your business would have to make to improve its performance in this area.

<p>| | |</p>
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a. |   |
b. |   |
c. |   |
d. |   |
e. |   |

‘Benefit’ of improving my current ratio? (score 1-9) ☐

‘Ease’ of improving my current ratio? (score 1-9) ☐

Quick ratio.

Step 1: What does it show?

Your quick ratio measures your business’s ability to pay bills that are due using only assets that are cash or quickly convertible into cash.

Step 2: How do I calculate it?

Your quick ratio can be calculated by taking the total of your current assets (debtors due in the next 12 months, cash etc.) excluding the value of any stock (raw materials, work in progress, or finished goods) and dividing this by the total of your current liabilities (payments due in the next 12 months, bank overdraft, etc.).

\[
\text{Current assets – stock} \div \text{Current liabilities}
\]

Step 3: How is my business doing?

Use the table below to record your results.

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<tr>
<th>Value three years ago</th>
<th>Value two years ago</th>
<th>Value one year ago</th>
<th>Current value</th>
<th>Trend</th>
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</table>

Step 4: Why might the ratio be changing?

Increase in value:

• You have managed your stock more efficiently.
• You have increased reinvesting profits made in the business.

Reduction in value:

• You have increased money invested in stock.
• You have borrowed money on your overdraft to buy fixed assets (for example, machinery or buildings).
Tips for improving your quick ratio:

- Use ‘just in time’ ordering to keep stock levels low and cash levels high.

Record below any reasons you identify for a deteriorating trend or thoughts around how you might improve your gross profit margin.

1.
2.
3.
4.
5.

Step 5: What is the benefit to me of improving this?

As with your current ratio, the higher the quick ratio, the more secure your business should be as you will be able to meet your debts as and when they are due without having to sell stock. A higher ratio also means your business should be able to take advantage of special buying opportunities, for example, one-off discounts offered by your suppliers.

It is equally important to understand the reasons for your business’s quick ratio. For example, a higher than average ratio may seem good, but not if it was higher due only to debtors you are still counting as an asset, but which are in reality bad debts you are never going to recover.

Step 6: Is this worthwhile or possible for me?

Record below any changes your business would have to make to improve its performance in this area.

a.
b.
c.
d.
e.

‘Benefit’ of improving my quick ratio? (score 1-9) ☐
‘Ease’ of improving my quick ratio? (score 1-9) ☐
Section 2

Key success factors and top tips.

Key success factors (KSFs) are the reasons why people buy from you and not from someone else, and reasons why your business can thrive, even during difficult economic conditions.

KSFs can be almost anything, depending on the type of business you own, and the sort of customers you have. Knowing your KSFs is critical – not only to keeping the customers you already have – but to attracting new ones.

We divide KSFs into four areas:

1. Business planning.
2. Finding and retaining customers.
3. Managing your finances.
4. Working with your local business advisors.

Business planning.

- Don’t commit to just one plan – try to stay open and flexible to change.
- Spread your risk and don’t become too dependent on one customer. For example, make sure no customer makes up more than 25% of sales.
- Ask your staff. Your people know you well and can be a good source of ideas to help improve the business. Telling them about future plans may result in useful ideas to move the business forwards and generate cash.

Finding and retaining customers.

- Don’t lose your marketing. Marketing is often the first budget slashed when times are tight, but a better bet might be to consider all the options and make the most of every marketing penny that’s spent.
- Watch your competitors. Keep an eye on competitors to see how they’re responding to the slowdown. If their methods are effective, consider what adopting similar methods would mean for you.
- Understand your customers’ credit situation. When the economy suffers, it’s important to understand your customers’ credit situation; unfortunately, some may get into trouble. For example, run a credit check on any large customers who make up more than 10% of your sales.
- Concentrate on giving your existing customers excellent service. If they’re disappointed, give them something back that exceeds the value of their problem. Meet them regularly. Do whatever it takes to understand them and their needs.
- Focus on return on investment. Why would a customer sign a contract if the ROI isn’t clear, especially during a downturn when they need to justify every bill? Produce detailed reports for each customer that breaks down every pound spent and the return achieved – and help them see the business case for dealing with you.
- Find out what they’re saying about you. Listen to what your customers are saying about you. For example, use measurable feedback forms, and monitor changes in feelings.
- Give customers a good deal. Reward loyalty by structuring deals based on longer-term commitment.

Managing your finances.

- Monitor your cash flow. Raise invoices promptly, chase any outstanding payments immediately and keep a safety margin in your accounts.
- Review your finance options. There are many sources of finance available (long and short term). Make sure you have the right mix – consider both asset and equity-based finance.
- Only raise the funds you need. When you need finance, always think about the risks. By planning carefully, you can have confidence that you will be able to afford to repay. For example, measure payment changes if interest rates change.

Working with your local business advisors.

- Get closer to your bank. Be upfront with your bank about your financial situation. Read the terms and conditions of any agreement to make sure you are happy with all of the detail. Make sure you know all of your options, and the implications of each – ask questions if you need to.
What are the factors that are helping your business be successful?

Spend some time thinking about your KSFs. You’ll probably find it most valuable if you can pinpoint four or five important areas, instead of producing a very long list of not-so-important ones. Write a few words describing what each factor is in the table below.

Looking at your KSFs, can you think of any measures that will help you track your performance in these areas? For example, if you identified keeping your production costs down as a key success factor, you might want to look at the percentage of stock lost through wastage. Alternatively, if your business’s success depends on the quality of service you provide, you might want to look at the percentage of complaints you receive to orders dealt with.

These KSF measures are specific to your business, so we can’t provide benchmarking data for you, but continuing to monitor them going forward will help you keep track of how things are changing.

<table>
<thead>
<tr>
<th>Number</th>
<th>Key success factor</th>
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Action plan.

Using the information you have found about your business from this booklet, you should create an action plan below, setting out exactly what you want your business to achieve, when you want it achieved, and how you are going to achieve it. For your action plan to be successful, you should make sure each point is:

- **Specific** – you know exactly what needs to be done.
- **Measurable** – you need to know if you have achieved it.
- **Achievable** – you must not attempt too much.
- **Realistic** – you need to have the resources available.
- **Timed** – you know when you want to achieve each action.

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<tr>
<th>What you want to achieve</th>
<th>When you are going to achieve it</th>
<th>How you are going to achieve it</th>
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