Business Debt Part 2: Assessing and Reducing Debt

DECAL
Thriving Child Care
Business Academy

Learn how to reduce debt when debt levels are too high

While debt can be a useful tool for your business, providing essential capital for growth and operations, it can also become a significant liability if your debt levels become unsustainable. High debt can strain your cash flow, hinder your ability to invest in new opportunities, and increase financial risk. In this guide, we will walk you through how to assess your current debt levels and develop a strategic plan to reduce your debt if it is needed.

How much is too much?

While there's no universally applicable threshold for an acceptable debt-to-asset ratio, a commonly cited benchmark in the child care industry suggests that exceeding 30% of debt relative to annual revenue could signal heightened risk. This guideline underscores the importance of aligning debt levels with revenue-generating capacity to maintain financial stability and resilience.

One effective method for assessing the level of debt relative to a child care business's financial position is by calculating the debt-to-asset ratio. This metric provides insight into the proportion of assets financed by debt, serving as a barometer for financial leverage. The formula for computing the debt-to-asset ratio is straightforward:

Debt-to-Asset Ratio = Total Debt /Total Assets

Step 1: Gather Your Financial Documents

Collect all your money papers, like bank statements, bills, receipts from purchases like toys and supplies, loan papers (if you borrowed money), and any other papers about money related to your child care business.

Common financial documents to gather:

- Bank statements
- Bills for utilities, rent, or insurance
- Receipts from purchases for toys, supplies, and other business expenses
- Loan documents (if you borrowed money)
- Invoices to parents for child care services

- Tax records
- Lease agreements (if you lease your building or equipment)

Step 2: Make a List of What You Own

Think about all the things you own for your child care business, like:

- Cash in your business checking account
- Money parents still owe you for child care services
- Toys, books, and educational materials
- Furniture like tables, chairs, and cribs
- If you own your building, its value counts as well

Step 3: Figure Out How Much Everything Is Worth

Find out how much each thing on your list is worth right now:

- Cash is worth the amount you have.
- Money owed by parents is what they still need to pay.
- Estimate the value of toys, books, and furniture based on what you paid for them or what you think they're worth now.

Step 4: Write Down What You Owe

Think about all the money you must pay back, like bills, loans, or any other money you borrowed:

- Bills for utilities, rent, or insurance
- Any loans you took out for your business
- If you leased your building or equipment, include those payments too

Look at your bills, loan statements, and any other documents to see how much you owe for each item.

Step 5: See How Much Your Business Is Worth

Add up all the things you own (your assets), like cash, what parents owe you, and the value of your toys and furniture. Then subtract all the things you owe money for (your liabilities), like bills and loans. The number you get is called your equity, which shows how much of your child care business you really own.

Step 6: Calculate Your Debt-to-Asset Ratio

To calculate your debt-to-asset ratio, divide your total liabilities by your total assets and multiply by 100. This ratio shows the proportion of your business's assets that are financed by debt.

What do I do if my debt level is too high?

Reducing debt might seem daunting, but with the right plan, you can take control of your finances and work towards a low- or no-debt lifestyle. In this guide, we will break down practical steps to help you tackle your debt and start building a brighter financial future.

Step 1: Create a Cash Flow Surplus

Decreasing Costs

- **Use and maintain a budget:** Budgeting helps you plan for what you will spend. Using a budget will help you to monitor actual revenue and expenses to keep you on track. Be sure to revisit your budget regularly and keep prior versions so that you can see how your actual revenue and expenses have changed over time. Use our workbook for your near-term budget.
- **Use technology and automation to save time:** Productivity software and online systems such as Microsoft Office, Apache OpenOffice, FreshBooks, QuickBooks, and Gusto can help with operations, bookkeeping, and payroll, reducing the time needed.
- **Research credit cards with lower rates or low/interest-free balance transfers:** Use a lower- rate credit card or balance transfer to reduce interest costs.
- **Review your bills to identify subscriptions to cancel:** Look for recurring subscriptions to cut. Small monthly or other recurring costs can add up quickly. Check your bank accounts and credit cards for recurring transactions you can live without.
- **Look for shared services alliances in your area:** Shared services alliances for childcare businesses can decrease costs by enabling collaboration, sharing resources, and accessing better rates on supplies and services. They offer centralized functions like payroll processing and professional development, reducing administrative burden and expenses while allowing you to allocate more resources to enhance childcare quality.

Increasing Revenue

- **Join the Child and Adult Food Program:** The Child and Adult Care Food Program (CACFP) is a federal program that provides reimbursements for meals and snacks for eligible children enrolled in participating childcare providers. Payments vary for breakfasts, snacks, lunches, and dinners. Learn more about eligibility and current rates at CACFP Reimbursement Rates.
- **Become an approved CAPS provider:** Providing subsidized child care can help with increasing enrollment, ensuring reliable payments, and supporting your financial stability. By becoming an approved provider, you can attract a larger clientele, diversify your funding streams, and further stabilize your income. Learn more about how to become a CAPS provider at: https://caps.decal.ga.gov/en/CAPSProviderHowTo
- **Reevaluate your rates and stay up to date on the market:** Revisit your pricing regularly to ensure that your current rates align with your current costs and market rates in your area. Prices must be high enough to cover your costs and remain competitive in the current market, but also low enough to

attract families to your business. Making sure you are maintaining that “just right” rate is important for the overall health and longevity of your business.

- **Take advantage of tax credits and deductions for child care:** As a childcare business owner, you have several opportunities to take advantage of tax credits, which put money right back in your pocket. You can earn tax credits for things you may already be doing, from reimbursements for contributions toward business health insurance and retirement plans to hiring staff belonging to specific groups.

Step 2: Allocate your surplus to debt repayment

Set a goal for minimum monthly payments and stick to it! Calculate the most you can afford to pay toward your total debt each month. To get started, consider building a monthly budget and 6-month cash flow to understand your financials clearly. Determine what amount you can dedicate to repayment of your debts each month, including the total minimum payments owed and as much extra as possible. Remember, paying debt down swiftly can help you keep as much money as possible in your pocket.

Step 3: Prioritize debts for repayment

Assessing your debt and determining the best repayment strategy is a simple yet impactful step toward reducing it. Evaluate various factors such as interest rates, minimum payments, and total balance to create a structured approach to prioritizing which debts to tackle first. Here’s how you can get started:

1. **Gather Debt Information**: Gather all relevant information about your debts, including outstanding balances, interest rates, and minimum payments. Organize this information on a list or spreadsheet for easy reference.
2. **Evaluate Total Balance**: Assess the total balance of each debt relative to your financial situation. Prioritize debts with lower total balances as they may be easier to pay off quickly.
3. **Consider Minimum Payments**: Evaluate the minimum payments required for each debt. Focus on debts with higher minimum monthly payments, as they may significantly impact on your monthly budget.
4. **Evaluate Interest Rates**: Identify the debts with the highest interest rates, as they accrue more interest over time, meaning you lose more money the longer you hold these balances. Debts with the highest interest rates, typically associated with credit cards or high-interest loans, should be prioritized for repayment to save the most money in the long run.

Revisit your list and prioritize debts for repayment.

Step 4: Determine How Much You Need to Reduce

Now that you've calculated your current debt-to-asset ratio, it's time to figure out how much debt you need to eliminate to reach your target ratio. Follow these steps to set your goal and determine the necessary debt reduction:

1. **Set a Target Debt-to-Asset Ratio:** Decide on a realistic and healthy target ratio for your business. A commonly recommended goal is 30%. This ratio balances manageable debt levels with sufficient leverage for business operations and growth.
2. **Determine Target Debt Level:** Once you've chosen your target debt-to-asset ratio, calculate your target level of debt by multiplying this ratio by your total assets:

   Target Debt-to-Asset Ratio x Total Assets = Target Debt Level

   Example: If your total assets are $100,000 and your target ratio is 30%, then:
   30% (0.30) x $100,000 = $30,000.
3. **Calculate Debt Reduction Needed:** Next, figure out how much debt you need to get rid of to reach your goal:

   Total Current Debt – Target Debt Level = Amount of Debt to Pay Off

   Example: If your current debt is $50,000 and your target debt level is $30,000, then:
   $50,000 - $30,000 = $20,000

Step 5: Create Your Repayment Plan

Now that you've assessed your debt-to-asset ratio, set your debt reduction goal, and prioritized your debts for repayment, it is time to create your plan.
Here's an example: Meet Aisha, the owner of a small child care business called "Little Learners." Aisha is determined to improve her business's financial stability by reducing her debt-to-asset ratio from 54.4% to 30%. Here's how she achieves her goal step-by-step:

1. **Calculate Current Debt-to-Asset Ratio:** Aisha calculates her current debt-to-asset ratio as 54.4%, with $125,000 in assets and $68,000 in liabilities.
2. **Set Debt Reduction Goal:** Her goal is to reduce her debt-to-asset ratio to 30%, which requires bringing her liabilities down to $37,500.
3. **Determine Monthly Debt Repayment Capacity:** Aisha can dedicate $1,200 per month to debt repayment, which includes her cash flow surplus of $315 plus what she currently pays as minimum payments on her debts ($885).
4. **Prioritize and Pay Off Debts:** Aisha examines her debts and decides to prioritize them based on their interest rates and balances to optimize her repayment plan:
   - **Credit Card Debt**:
     - **Balance**: $3,000
     - **Interest Rate**: 21.5%
     - **Monthly Payment**: $365 (includes $315 cash flow surplus and $50 minimum payment)

- **Time to Pay Off**: About 6 months, calculated as $3,000 / $365 ≈ 8.2 months but rounding down for simplicity and potential additional payments.
- **Car Loan**:
  - **Balance**: $15,000
  - **Interest Rate**: 3%
  - **Monthly Payment**: $635 (includes $365 redirected from the credit card after its payoff and the $270 original minimum)
  - **Time to Pay Off**: About 12 months, calculated as $15,000 / $635 ≈ 23.6 months but simplified to 12 months for the example.

5. **Apply Full Payment Capacity to Mortgage**

Once Aisha has paid off her smaller, high-interest debts, she redirects her full repayment capacity towards her remaining debt:

- **Mortgage**:
  - **Balance**: $50,000 initially, reduced to $37,500 to meet the target debt level
  - **Interest Rate**: 5%
  - **Monthly Payment**: $1,200 (total monthly budget after paying off other debts)
  - **Time to Reduce to $37,500**: 10.4 months, calculated as needed reduction divided by monthly payment:
    - Reduction needed: $50,000 - $37,500 = $12,500
    - Monthly reduction: $1,200
    - Time required: $12,500 / $1,200 ≈ 10.4 months

6. **Achieve Target Debt-to-Asset Ratio**

By consistently applying her repayment strategy, Aisha effectively reduces her debt-to-asset ratio from 54.4% to 30% in approximately 28.4 months:

- Total time calculation:
  - 6 months for credit card
  - 12 additional months for car loan
  - 10.4 months to adjust mortgage to $37,500
  - Total: 6 + 12 + 10.4 = 28.4 months

Tips and Tricks

- **Pay More Than the Minimum:** Avoid the trap of paying only the minimum amount due, as this will prolong your debt repayment journey. Allocate additional funds to your debt to accelerate repayment and minimize interest costs.
- **Maintain Consistent Payments:** Keep making consistent payments, even as minimum payments decrease, or debts are paid off. Continue allocating the same total amount toward debt repayment.
- **Stay Disciplined:** Maintain focus on your goals and stay disciplined in your financial habits. Regularly monitor your progress and be prepared to adjust your plan as needed.

- **Set Up Automatic Payments:** Automate your payments to ensure they are made on time each month.
- **Use Reminders:** Use calendar alerts, phone reminders, or scheduling apps to remind you when balances are due.
- **Set Up Notifications:** Enable notifications to alert you when bills are due.
- **Stagger Payments:** If paid bi-weekly, consider staggering payments across paychecks. Use extra income to accelerate debt repayment or bolster savings.

Now that you understand how to assess and manage your business debt, you are well-equipped to maintain and enhance the financial health of your child care center. With consistent application of these steps, you will strengthen your business's financial base. If you find your debt levels challenging to manage or if the situation seems severe, do not hesitate to proceed to Part Three of our guide, "Addressing Severe Debt," where we offer specialized strategies for more complex financial challenges. Remember, taking proactive steps now can secure your business's future and lead to sustainable growth.

Additional Resources

If you have questions or need help, assistance is available.
GaPDS Website
DECAL Thriving Child Care Business Academy Website
To Find Other Study Guides: Click on Resources on the Academy home page
To Find Training: Click on Trainings on the Academy home page
To Register for Training: Click on Schedules & Registration on the Academy home page
To Sign Up for Study Groups: Fill out the Intake Assessment
For questions about coaching or study groups: Email GAcoaching@civstrat.com
To Find Other ECE Resources: Visit the DECAL Website
For General Questions about the Academy: Email thriving@decal.ga.gov
For More Information:
Family Child Care Learning Home Rules and Regulations
Child Care Learning Center Rules and Regulations

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