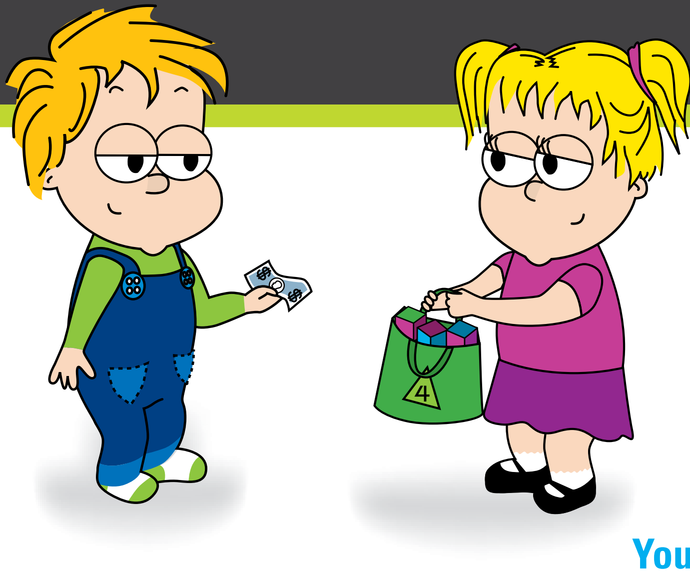
TRUTH 4

About Financial Management

A Healthy Bouncy Business makes turnover, cash and profit



Are we making money?

Cash, profit and turnover have nothing to do with each other

A major cause of downfall of many small businesses is confusion between cash, profit and turnover in a business.

The state of the business' bank account is never an indication of the profitability of the business. And a business that is profitable may still not be able to pay its debts, can become insolvent and go out of business. Many service businesses especially have run aground while being incredibly busy - so busy that they neglect to invoice.

A business must carry out enough business turnover in a sufficiently profitable manner to pay for its overheads. It must bill profitably for that business regularly -weekly or even daily. And a business must collect payment for those bills as soon as possible, so it has enough cash in its bank account to meet its obligations when they are due. In most businesses there is virtually no direct connection between the three elements of turnover, profit and cash.

A plumbing business, for example, might complete one job on Tuesday that takes an hour. The business might be able to invoice the client $200 for the job and the raw cost to the business of this hour's work is only $50. This looks like a very healthy 300% profit margin.

However, until the day that the $200 is actually in the business' bank account as cleared funds, the business has a negative cash flow and needs to pay its costs from other funds. Moreover, as the cost to the business for one hour was $50, the business would have at least eight times that cost (i.e. for an 8hr work-day), or a total of $400 for a whole day of operation. The business must therefore send at least two of those invoices on a given day just to survive, or break even.

In a plumbing business it is expected to pay employees every Friday. And hence, unless the business actually collects that $400 by Friday as cleared funds, the employees have to be paid out of thin air.

Turnover can be measured indirectly through job sheets or time sheets in a service business, or through indirect recording systems in manufacturing environments, for example.

Profit is measured in the 'Profit and Loss' reports that can be produced by a bookkeeping system. Profit is a function of the price that the business charges for its products or services, minus its direct and indirect expenses.

Cash directly impacts the business' ability to carry out its core functions. Profit impacts the long term survival of the business.

Cash is primarily reported via bank statements, and needs slightly more complicated systems to forecast and manage within bookkeeping systems. How much cash a business has in its accounts is directly related to payment and trading terms, and how rigorously they are adhered to in the business.

Many businesses become insolvent even though they showed good profitability, and just as many businesses have failed from 'living beyond their means' - simply because the bank account looked so flush.

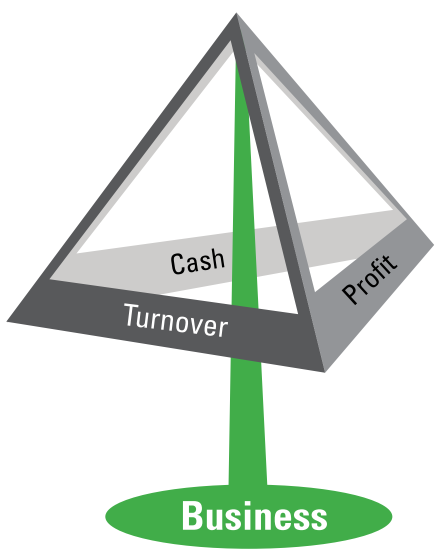
In a Healthy Bouncing Business, equal attention is paid by the business owner to turnover, profitability and cash.

A simple mantra that the owner of a Healthy Bouncy Business repeats, over and over:

- I need to turnover $xxx per week
- I need to invoice $xxx per week
- I need to collect $xxx per week

Where $xxx is the respective minimum amount required to be profitable.

Is everything in balance?



Bob's Bedtime Story

Once upon a time a long, long time ago in a land not unlike Australia... I worked with a small business owner called Bob, who had a solid plumbing business. When I started working with Bob he struggled every week to pay his bills, and many weeks he had to forgo his own wages to pay his boys. Bob and I worked out that he needed to deposit at least $6,500 in his bank account, 52 weeks of the year, to pay his bills. Allowing for holidays and Christmas - and including an allowance for profit -, Bob made it his mantra to carry out $8,000 worth of work, to invoice $8,000 and to collect $8,000, week in week out, 48 weeks of the year.

Within a month we started noticing a difference in his bank account, and it soon became obvious to Bob that clients who don't pay on time are not worth having. Bob started to become much choosier who he worked for. He actually 'fired' about 15% of his client base over the subsequent four months. At the end of our six month engagement, Bob's business had become the very essence of a Healthy Bouncy Business.

And Bob lived happily ever after...

Next Steps

1. Calculate what it costs you to open the doors each week.
2. Work out, or ask your accountant, what you have to charge/earn every week to break even.
3. How many days does it take you to collect payment, on average?
4. If you are growing, do you know what cash needs you will have?
5. Ask your accountant and/or business coach to help you set up some way to manage cash flow forecasting for your business.

Resources

- *The Ten Truths* Website: www.thetentruths.com.au/resources/finance
- Article – Roland Hanekroot: "Profits are a Liability" www.thetentruths.com.au/Downloads/Profits-are-a-liability.pdf
- Worksheet – Basic Cash flow forecasting, ANZ Bank: www.thetentruths.com.au/Downloads/Cash-Flow-Template-ANZ.xls
- Book & Website – Phillip CVampbell: "Never Run out of Cash" www.neverrunoutofcash.com

Remember

A business that does not make profit is a hobby.

And unless the profit actually hits your bank account you're better off going fishing.