



THE SIMPLE STEPS FOR BUSINESS PROGRAM

First Steps to Sound Financial Management of your business

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What does it take to make a success of your small business... how can you avoid adding to those frightening statistics about failure rates of small business.

In this series of articles and associated webinars by the authors of “The Simple Steps for Business Program” you will be introduced to the basic concepts and knowledge that will set you up to become a

successful ‘Business-Owner’, as opposed to a struggling ‘Business-Doer’.

Format

The format of each episode in the “First Steps” series is to explain the basics of the topic and then in line with the principles of “The Simple Steps for Business” program, to suggest some “First Steps” you can take straight away to put the knowledge into action.

In the first of these articles we’ll look at Financial Management: What do you need to know and how do you need to apply that knowledge to put your business on a solid financial footing?

3 Principles

There are 3 principles you need to understand to manage the finances of a business well:

- 1) Why do we need to make profit?
- 2) Profit and cash are not the same thing at all and they don’t even have a direct relationship between each other.

- 3) Cash is what you must worry about all the time... not profit

Why Profit?



Let's address the principle about Profit first. The first thing to understand about profit is that it is not the purpose of business. Profit is a vital component of business, but it isn't the reason the business exists. The Purpose of your business must be something much more important and something your customers actually care about. (More about this idea in the article about Purpose and Vision)

The 3 Functions of Profit

Profit has 3 functions:

- 1) To pay investors and stake holders in a business a return on their investment.
- 2) To provide the business with funds to invest in itself to grow or develop the business.
- 3) As the thing by which we measure how well we are doing in running the business.

The first function is straight forward, if someone invests \$100 or an hour's work into a venture, that person wants to see a return for that investment. That return can only be payed out of the profits of the business.

The second function is also straight forward, in that, if you want to buy a new machine or tool or vehicle for your business you need to have the money to pay for that. Profit is what provides that money. (You can borrow for that purchase of course, but then the purchase is effectively made out of future profits)

The third function is about this: How do we know if our business is going well or not so well? The only clear method to answer that question is to keep track at the financial numbers and profit is the most important of those.

THE SIMPLE STEPS FOR BUSINESS ... FIRST STEPS:

As mentioned in the opening paragraphs of this article, we will suggest some "First Steps" actions you can take right away, that will get you started on implementing the topics and principles we discuss:

- 1) Have a look at a great blog post on the Times of London about the importance of profit in business [follow this link](#) to the resources page for this topic

- 2) If you are not already doing so, start by paying yourself a regular “wage”. A weekly or monthly amount you can live on as a minimum, and record this wage in your books as an expense to the business. You may decide to invest this money back into the business if you don’t need it to live on, but by paying yourself such a wage you will gain a more accurate insight into the profitability of the business and you will start to see how much money you are actually investing into the business and therefore should get a “return” on in the future.
- 3) Start a proper bookkeeping program (Xero, MYOB, Quickbooks, Saasu, Freshbooks) and ensure it gets kept up to date at least monthly.

Profit and Cash

The second principle about profit and cash is what brings a lot of small businesses unstuck. A large proportion of the businesses that make up the horrendous statistics on failures in small business do so because of a lack of understanding of this principle.

Profit is a simple sum (on paper) of sales minus costs. So if you sell stuff in a week for a \$100 and it costs you \$50 in raw materials that week and \$25 in office costs, it means that you have made \$25 profit that week.

Cash (your bank balance) bears little relation to those numbers in most cases. The \$100 of stuff you have sold might not be paid for that week or even that month. You also might have had to pay for the raw materials some time previously and your office costs (staff and rent etc) may have to be paid every Friday. So that at the end of the week your bank account will actually be significantly in the red even though you’ve made a profit.

Cash Flow



So cash needs to be calculated in a different and slightly more complicated manner than the simple profit and loss equation.

When thinking about cash it is useful to think in terms of flow... money flowing in and out of your account, like a river flowing into the sea. If it rains upstream in Queensland for example, it may take a month for the

Darling River to start swelling downstream in South Australia. So when talking about cash we usually talk about cash flow.... Money flowing in and money flowing out. If more money flows into your bank account in a given period than flows out in that period, your bank account swells and vice versa.

THE SIMPLE STEPS FOR BUSINESS ... FIRST STEPS:

- 1) Read this article: “Profit is a liability”, about the difference between profit and cash-flow by Roland Hanekroot [follow this link](#)
- 2) Here is an article in Inc. Magazine: “5 Ways to improve your cash-flow”. The article explains the long term strategies for improving your cash-flow dramatically. Read the article and ask yourself what steps you can apply in your business: [follow this link](#)

Cash is the main thing



And that brings us to the third principle that you need to understand about financial management of the business.

I said that the thing to worry about in your business is Cash and not Profit. For most people this is a counterintuitive statement.

The truth of this principle is actually much more straight-forward than you

might think, because:

Only cash can be used to pay for stuff

Theoretically, your business may never make a profit and yet survive, as long as you continue to have enough cash to pay the bills, your staff, your raw materials, the rent etc. Obviously without making a profit, the business will ultimately run out of cash, but that can take years in some circumstances. So as a business owner who is committed to put his business on a solid financial footing, Cash-flow must always be your first concern.

THE SIMPLE STEPS FOR BUSINESS ... FIRST STEPS:

- 1) Article by Roland Hanekroot: “Cash-flow, the Basics”: [follow this link](#)
- 2) Ask your accountant or bookkeeper for a simple cashflow spreadsheet and either start to use it yourself monthly or ask your bookkeeper to do so for you, you’ll be surprised how easy it is to start to get a handle on the cash flowing in and out of your bank account.

Roland Hanekroot and Kym Heffernan are the authors and founders of [The Simple Steps for Business Program](#), a comprehensive business coaching and development program incorporating online videos, webinars, interviews with experts, are comprehensive workbook and a big range of practical tools and resources. Roland and Kym run a series of free “First Steps” webinars on a number of the key topics covered in The simple steps program on the 4th Thursday of every month at 7 pm... book in now for the next opportunity.