WORKING CAPITAL

Cash Management

Remember, your job is to manage working capital (cash) and ensure your company has enough of it to grow and to weather economic downturns.

We encourage you to read Simple Numbers, Straight Talk, Big Profits! by Greg Crabtree:

http://www.amazon.com/Simple-Numbers-Straight-Talk-Profits/dp/1608320561/ref=sr_1_sc_1?ie=UTF8&qid=1447998899&sr=8-1-spell&keywords=straigth+talk+big+profits

At a minimum read the first couple chapters.

This book will give you a basic financial understanding of your business.

If you do not have accurate books on a monthly basis you lack your most basic tool for managing the health of your company.

If you make over 250k per year in Gross Revenue, we recommend you receive revenue (deposits) and pay bills weekly.

If your business makes under 250k in gross revenue, receive revenue and pay bills on the 10th and 25th of each month.

Make sure QuickBooks is 100% accurate at the same time. Reconcile any accounts that you have received bank or credit card statements for.

Timely and accurate financial statements are a must if you intend to grow a large, healthy, profitable company.

Start reviewing your Profit and Loss statement monthly. If you do not understand what your P&L statement is telling you, many free YouTube videos will demystify your P&L. Likewise, Greg Crabtree discusses the P&L statement in his book.

Start looking at your balance sheet. Most companies only look at the P&L. Your balance sheet tells you the financial health of your company at a specific date in time.

In addition, start writing your bank account balance on a sheet of paper everyday for 90 days. Consider following this practice long term. This is a core financial metric you must know at all times. It is your top responsibility and provides clues as too the health of your business.

Further, writing this number daily zeros your mind in on what is your most important responsibility: cash management.

If you follow our suggestion to stay on top of your books, you will be able to make wise financial decisions. Most companies look at their bank balance to decide if they can afford to pay bills or invest in people and marketing. This is a very dangerous practice and will become disastrous as the business grows in size.

We recommend knowing your daily cash balance.

However, knowing your daily cash balance is not enough.

Your business decisions should be made using your P&L, Balance Sheet and Statement of Cash Flow.

From these statements you will be able to learn your core monthly expenses.

For example, let's say your core expenses to run the company, including payroll, are $35,000/month. If you want to add a $4000/month employee and increase your marketing budget by $1000/month you know your new base expense will become $40,000/month.

Can you afford these expenses now? What about during your slow season?

Looking at your current bank balance and discovering you have $29,000 doesn't tell you anything. For example, maybe $5,000 of that amount is owed to the government for sales tax. Maybe $9,000 to the government for payroll tax. $13,000 to your Credit Card Company and $15,000 in payroll is due in 8 days.

Your bank balance doesn't tell you any of this. Your financials tell the story of your real financial health.

They are critical.

If you don't pay yourself a salary or you pay yourself a very low salary your first priority is to get yourself on Payroll. We like PayChex as a payroll service.

Until you pay yourself a consistent, fair salary your profit earned will always be overstated on your P&L.

Taking money from your company account to pay rent and personal expenses is a very dangerous practice. Again, we suggest paying yourself a salary. If you are a new company it will probably be a small amount. Starting this practice while small trains the behavior you want to continue as the organization matures.

We also recommend paying a payroll service to handle payroll vs. doing it yourself. Yes, it costs a little money but it will greatly simplify your life and eliminate risk you don't want to incur. Not paying payroll tax is a serious offense. If you don't set aside enough money and can't pay your payroll taxes you are personally liable. Using a payroll company forces you to pay your payroll on time.

As discussed during Jonathan's Profit Talk, the point of business is to generate profit. Jonathan mistakenly focused on client count over profit in the early years of his business.

To focus your mind on Profit we suggest setting up a bank account specifically for profit.

The concept is explained in Profit First by Mike Michalowicz.

http://www.amazon.com/Profit-First-Transform-Cash-Eating-Money-Making/dp/0981808298/ref=sr_1_1?ie=UTF8&qid=1447998931&sr=8-1&keywords=profit+first

If you don't have time to read his entire book we recommend reading chapters 2, 3 and 4.

The concept is very simple.

We suggest you setup three bank accounts.

- Income Account (check deposits and credit card payments get deposited here)
- Operating (you pay your expenses out of this account)
- Profit (you transfer money [profit] to this account 2 to 4 times per month)

Here is how you apply the concept:

First, you need to figure out or guess at how much profit you are making. If you believe you make 10% profit you will start transferring 10% of your monthly revenue to a Profit account.

Imagine once per week you transfer money from your Income account to your Operating account so you can pay bills.

If you have $10,000 in your Income account, you need to transfer 90% to your Operating account and 10% to your Profit account.

You are not allowed to ever touch the 10%. You don't get to spend it for a bigger house, faster cars, or better vacations. You save it and build a big financial pad for your company. It's your money. You are committing to save it so you can weather any economic storm or have money to invest in future growth opportunities that will make you more profit.

Again, this is your money. You are simply committing to save it vs. spend it.

After you have saved 2 months of gross revenue in your Profit account you can have the rest. You will take the excess money as a profit distribution.

As your company grows you need to increase the amount saved in your profit account to equal two months of your growing gross revenue. If you are really aggressive save three months. However, most experts agree if you save two months of gross revenue you are in good shape.

This also assumes that before you start taking the excess profit you have paid off your debt.

The advice isn't popular or fun, but it's how you build a super safe, secure, and healthy company. It's also how you become wealthy.

In the Profit First book, Mike recommends a Tax bank account in addition to a Profit account. The idea is solid; however, we do not practice it. The Profit account contains the money from which our tax bill on profits will be paid so we do not feel the need to separate the two. Please note, if you are not setting aside enough profit in your Profit account you may not have saved enough money to pay taxes on your actual profits.

It is imperative you know that the sum of your bank account balances will not match the profit shown on your P&L and tax forms. You could have very little money in the bank and owe profit. This is another reason having accurate financials throughout the year is very important. Accurate financials eliminate year-end surprises.

There are numerous reasons this may occur. Three common examples:

- Paid down a line of credit in this calendar year that you ran up last calendar year.
- Paid off credit card balances this year for expenses charged and expensed last year.

- Paid cash for trucks and equipment that cannot be fully expensed and must be depreciated.

One final note regarding your Profit account: if you do not currently pay yourself a fair market salary, go ahead and start your Profit account.

Initially contribute only 1% of your gross revenue. It's a small amount; however, it will train behavior and create a habit. It forces you to think about how much money you are making or not making.

Focus on getting your salary to a market based wage. Once you accomplish that start to work on upping the amount you contribute to your Profit account each quarter.

If you would like to learn more, the Profit First book gives a better explanation of this concept. It is a very simplistic but powerful idea. You ultimately get what you think about, focus on and consistently work towards.

Finally, regarding cash management and protecting your business, we recommend creating a back-up plan while you build a large financial pad.

Setup a high limit credit card. Setup a line of credit with your bank.

If you are not naturally a good steward of money, if you are tempted by debt, get a safe deposit box at the bank. Lock your credit card and line-of-credit checkbook in the account.

The card and line of credit are not meant to finance your business as much as they are to protect you in the case of a massive economic downturn or catastrophic business event.

We are not negative on the prudent use of debt, especially vehicle debt. However, our recommendation is to use debt as little as possible to grow the business.

Access to debt can become a crutch, allowing business owners to avoid or put off fixing systemic business issues. When you lack debt to solve problems you are forced to find creative solutions.