Cash flow: the measure that matters most

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THE FAMILY ENTERPRISE

This time of year — "tax season" — finds me working closely with clients to take a historical look at their business performance over the past 12 months. And I'll be honest with you — neither they nor I relish the exercise.

Sure, they are pleased when I help them identify ways to save on taxes, but their concerns are always with this day forward. That is why I make it a point to put last year's "numbers" in a future context.

Business owners worry. It comes with the territory. And I don't mean to denigrate my profession, but tax returns, balance sheets, and even statements of income fail to answer most entrepreneurs' core concern: "How am I doing?"

Addressing that question requires consideration of a multitude of factors, which may be why many accountants prefer to stick to historical reports. But, as in most areas of life, the easy answer is not always the right one.

The "product" of your relationship with your professional advisers should be much more than a filed return or balanced books. Look to those you pay for advice to provide you with the peace of mind that comes from knowing that you are on track to achieve your goals. Does your accountant even know what your goals are?

I am talking here about financial goals as they relate to both your business and your personal life. As a business owner, you know that the one is inextricably tied to the other, and your discussions with your business advisers should cover both.

For the clients I work with, it all boils down to cash flow. This single measure of financial health affects the ability of business owners to manage day-to-day operations while planning for the future of the enterprise. And on a personal level, cash flow drives decisions relating to retirement, education savings, home ownership, and leisure pursuits.

The good news is that your tax return provides an excellent primer for this discussion. Start with your business' net income for last year as the basis of your cash flow analysis. Add to this number the respective amounts you paid during the year for depreciation, amortization, owner's compensation, and income taxes. The resulting figure is the cash flow potential of your enterprise.

It amazes me how few business owners perform this simple analysis. Those who don't lose the opportunity to improve their results because they aren't even sure where they stand in terms of performance.

One question I usually get after walking my clients through this evaluation is, "How can I do better?" It's a classic case of what gets measured gets done.

The first step in maximizing cash flow is reviewing your projected monthly and yearly gross revenue production. Subtracting your planned expenditures will provide you with a starting point. Now ask yourself whether this amount will support your financial objectives. The key here is establishing a system that answers basic financial questions.

Other steps include looking at your credit policies. Do you enforce them? Do they need to be adjusted? Are your customers as credit worthy as you think they are? Remember, their cash flow issues can quickly become your cash flow issues, so it is important to review their financial standing on a regular basis.

Take a close look at your budgeting process, too. How realistic are your revenue projections? Do you, like many companies, simply tack an arbitrary percentage onto last year's figure while keeping marketing and other expenses constant? A more disciplined approach, which I advocate, wipes the slate clean and reviews projected income and expenditures line by line.

It is a good idea, too, to cast a critical eye on your compensation models. Do you, as a matter of course, provide yearly raises to your employees? Is this necessary? Perhaps not, especially in light of ever-rising health care costs which business owners typically absorb.

Check on compensation benchmarks for similar positions within your industry. If your pay is high, you have an opportunity to scale back. If it is low, you need to plan for an increase in payroll or face losing employees.

Your product's selling price should also be revisited to ensure that your revenues are not being hurt by either over- or under-pricing. At the same time, consider restructuring your bank debt in order free up necessary cash.

These financial moves should be coupled with a serious look at your operations to identify and overcome inefficiencies that constrict your cash flow. Consider your current reality as your launching point for improved performance, which in the small business world is measured not so much by the bottom line as it is by cash in the cigar box.

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