<u>Cash is the king</u>

Businesses don't crash and burn because they are unprofitable. This is not to say that a business is *viable if it isn't profitable* for an extended period of time but even a profitable business can go bust if there's no cash to pay salaries, suppliers and other creditors.

To demonstrate this let's assume a business sells goods worth £100,000/month at 60 days credit but pays its suppliers with 30 days credit. Let's also assume that total suppliers' bills (including local taxes and other dues) are $70,000/month and salaries are $20,000. The business borrowed £100,000 to start operations, repayable in 48 equal installments of £2300/month (principal + 5% annual interest).

This means an EBITDA (Earnings Before Interest, Tax, Depreciation and Amortization) of $10,000/month. Many businesses would be very happy with a 10% EBITDA. Depreciation and Amortization are non-cash expenditures (more on that in coming posts) but interest and tax are payable every month. Let's assume that those 2 expenses are £3,000/month so we're talking about a 3% net profit – not a stellar performance but not bad for a budding enterprise.

So the company is returning a profit, even on its first month of operation but than reality hits - principal repayments are not considered an expense in Profit and Loss reports so the business may look profitable on paper but have a negative cash flow and collapse.

For those (like me…) that read numbers better than words consider the following :

Item	Profit and Loss
Sales	100,000
Costs	-90,000
EBITDA	10,000
Interest and taxes	-8,000
Net profit	2,000

Item	Cash Flow month 1
Sales income *	0
Bank loan	100,000
Costs	-90,000
Interest and taxes	-8,000
Loan repayment	-2,300
Cash flow	-300

* No actual income due to 60 days sales credit

Now, a £300 loss might not be so bad and a friendly conversation with the bank manager may sort this out for one month but remember we're only playing with hypothetical numbers here. The £300 can easily be £3000 and this is only the first month…

So every business owner must consider the following, on top of just making sure that they sell for more than they buy:

Buy/sell credit gap -
EBITDA -
Taxes -
Loans repayment -

And last but not least – post-dated cheques. Many business owners keep a sharp eye on their bank account(s) on a daily basis and feel happy as bunnies when they see a black figure, only to be sand-bagged by a check that was long over-due but the beneficiary failed to deposit on time. To thoroughly manage cash flow it is *imperative* to keep a list of all checks and standing orders that are yet to be paid, and treat each one of them as if it has already been charged to the bank account even if it hadn't. This means deducting an over-due check amount from the available bank balance on the theoretical payment day and regard the payment amount as if it had already been cleared. You can use a MS Excel spreadshit, a Moleskin notebook or any other tool (I use an online customizable CRM software).

Keep your eyes on the ball at all times. One bad cheque can destroy a viable business for good.