

# SMALL BUSINESS REVIEW

Resources for Successful  
Small Business Owners



## YOUR MONEY:

### Planning For Profit

**Opening a profits account is a simple yet effective cash flow management tool.**

July 2007, By Guy McPhail

If you are like many small business owners you find that some years are profitable and others are profitless. Have you been able to determine the reason for the disparity between profit and loss? Maybe you can credit the ebb and flow of year-end profits to an obvious predicament such as losing valuable customers, an inability to cultivate new clientele or serving a market that is struggling itself. But, void of a predicament, the likely conclusion is the fact that you simply don't know where the money went. This type of problem is a financial planning issue that can be remedied with a cash flow management solution.

Maintaining adequate cash flow is one of the shared characteristics among well-run companies. In addition to adequate cash flow, well-run companies also set certain benchmarks and ratios that they strive to achieve or maintain. Generating accurate and timely accounting reports, and setting and managing tight budgets enables these businesses to plan for having profits come year-end and increases their ability to produce them on an annual basis.

#### **The profit tactic**

One novel technique I have found that is very powerful for small business owners is actually budgeting for profit by starting a profits account that is funded monthly.

Let's say you and your financial planner have analyzed your company finances and your year-end profit and loss history. Some years were profitable and others were profitless. But on average the good years showed a profit of around \$120,000 after paying all expenses including your salary. So, you decide to plan on making \$120,000 in profits during the coming year.

#### **Fund the profit account regularly**

Here's my profit tactic: Open a new, separate business money market account for your profits account. Write a check for \$10,000 (\$120,000 in profits divided by 12 months) at the start of the month. Don't wait until the end of the month. Deposit the check in your company's new profits account. Now, if you find you have to dip into your profits account to pay bills you immediately know you have a cash flow management issue that needs to be resolved and that you may be in jeopardy of achieving the desired profits for the year.

I have noticed that small business owners using this tactic often struggle in the first few months not to make withdrawals from the money market profits account, but later on they get better at managing their cash flow. As time goes on, many find themselves even increasing the amount set-aside annually in their profits account. This is just an expansion of the golden rule of business you have heard before: Pay yourself first. Here, we are applying it to your business.

For some businesses, making 12 equal amount deposits into a money market profits account is not realistic because of the particular ebb and flow of expenditures and income they may experience. One such example is a clothing retailer who may have costly biannual inventory expenditures for fall/winter and spring/summer merchandise. For a situation such as this, I would help the business owner work out a tailored plan based on fluctuations. She might write a bigger profits account check a month or two after the big expense, and write a smaller check (but always at least a token amount) for the month of the big expense. So, two months each year the clothing retailer would write herself below average profit checks, two months she'd write above average profit checks, and eight months she'd write average monthly amount profit checks.

As I observed, the key to making sure that planning for profits pays off for a small business often lies in the owner's ability to become an expert in cash flow management.

In my next column, we'll look at steps you can take to begin to master the cash flow at your business.

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