Finance Touch Points

Funeral service is just like any other business: When you get right down to it, it's all about the numbers. If profits are coming up short – or not present at all – and business seems to be strong, something must be wrong. Our finance partners are here to help, offering insights on some of your most common finance-related questions.

Q “When it comes to my business, how much of my profits should I be ‘saving for a rainy day?’”

A Bill Williams, president and CEO, FSI

Saving some of your cash “for a rainy day” is extremely important. If you have adopted this mindset, congratulations! It likely means you have some excess cash on hand or you are thinking ahead instead of just operating in the present.

In either scenario, great opportunities exist to use your cash to ensure you have ample funds to continue operating successfully during times of volatility and to invest in your business.

Let’s first look at how much cash you should be saving for an emergency. Typically, businesses should have liquid assets – or, in other words, cash in bank accounts and very liquid investments – equal to three-to-six months of operating expenses available at all times.

While that is a common practice, I recommend taking it a step further. If you have the means to do so, separate your business’ cash into a monthly operating account and a contingency fund.

The operating account should simply maintain a sufficient balance to cover the lowest cash-inflow month for your business. Your contingency fund, on the other hand, is where the amount should equal three-to-six months of operating cash for those rainy days.

How to Allocate Funds for Both

Monthly Operating Account

To ensure your operating account maintains a sufficient balance to cover your lowest cash-inflow month, analyze the last 12 months of expenses and overhead costs that are spent every month, regardless of sales volume. The month with the lowest net income should serve as your guide.

Contingency Fund

To recap, this is the fund where three-to-six months of operating cash should be available for rainy days. To calculate this amount, follow four steps:

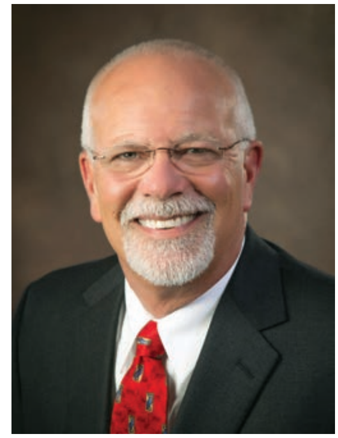
1. Start by adding together your current assets, including bank balances, outstanding accounts receivable and inventory value.

2. Take that number and subtract your annual liabilities for the year, which may include taxes due, accounts payable and loans payable.

3. Now, divide this amount by 365 – this will calculate your daily operating capital.

4. Lastly, multiply your daily operating capital by the number of days you’d like your contingency fund to last. For example, 90 days for three months or 180 days for six months.

What About Worst-Case Scenario?



If you have done the math to determine your three-to-six-month contingency fund and you are still feeling unsure about the amount, you can take further steps to ensure you have made the right decision. The best step to take is analyzing your cash flow during all of the possible scenarios your business may face.

For your worst-case scenario, consider what would happen if a natural disaster hit your facility. A natural disaster could damage or destroy a significant portion of your building, which would cost substantial sums of money to repair. A data hack may result in significant legal fees or investment in new technology. For any of these worst-case scenarios, consult with the appropriate professionals in your network to understand what these types of situations could cost you.

But, don’t go overboard. While your contingency fund is important, you should ensure your business has sufficient funds to continue operating efficiently. In this case, it is all about finding a balance.

I Still Have Cash Left Over. What Now?

Too much money and not sure how to use it – what a great problem to have!

Once you have calculated a stable amount for both a contingency fund and an operating account, you should start budgeting for the next three-to-five years. This scenario is the stage where you can get strategic and assess your longer-term business goals and the amount of cash necessary to help you achieve those goals. You may consider investing in new technology, adding more staff or exploring the possibility of expanding through an acquisition.

If you still find that you have cash to spare, only then should you pull it out of the business for yourself. I strongly advise consulting with your CPA and financial planner first to determine the best approach for distributing and investing those funds.

Whatever you decide, don’t just let your money sit. You worked hard to get to this point and have a tremendous opportunity to start taking steps to grow your business and ensuring it is prepared for the future.

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