FINANCE
101

By Daniel M. Isard

2020 VISION

The Sledge Hammer Approach to Business Planning in 2019

A new lineup of coverage in this column for 2019, starting with cash and receivables.

I am a child of television. When I was born, it was black and white, just three channels, it fed into my house through the air and perfected on the screen by how I'd twist the antenna wires. (I know, that explains so much…)

Today, there are a thousand stations brought in via satellite, super-duper color and even 3-D watching! The audio is movie theater-quality surround sound. But still I am fixated on home repair, restaurant makeover and hotel refurbishing programs. If the star of the show can't wield a sledge hammer, I flip to one of the other 997 channels.

Business is the same way.

The Director has introduced the 2020 Vision concept to raise the bar on the importance of planning for the future life and success of your business as we sit on the cusp of the year 2020.

Thus, 2019 will be tune-up year. I ask my readers over age 65 to cut out this column and file it someplace so you can retrieve it for review from time to time. Readers 35 to 65, scan this article. Those under 35 can find it online or wait for the video blog. This issue is the premise of this column for the next two years!

I will be wielding a sledge hammer over 11 columns and will destroy the walls of your building and business. Like *Fixer Upper's* Chip Gaines or *Property Brothers'* Jonathan Scott, I will destroy something to make it better. And just like the people off-camera, I will have a well-constructed plan so that we don't try installing the toilet before putting in the plumbing. Following is the order of deconstruction:

March: The Building

April: Marketing

May: Company Structure

June: Debt

July: Pricing

August: Technology

September: The Ultimate Goals of Success

October: Human Resources

November: Merchandising

December: Business Succession Planning

By next year, you will have a plan and we will then work to implement it. Trust me – everything will come into 2020 focus.

CASH AND RECEIVABLES

Nothing is more important to a business. Together, cash and receivables are referred to as working capital. In funeral service, while you cannot control death, you can control your business. Death occurs at a rate of about 8.2 people per thousand population each year. So, while you wait for it to affect those families that want to use your funeral home, you better have enough working capital or risk of going out of business.

To start, you should know how much working capital you need. I employ three tests to judge the amount. But first, let me make you aware of facts you need to know about your business.

Size of Your Business

Size matters. A small business does fewer than 120 calls per year and serves one or, at most, two families a week. That means it may go a week or even two with no calls. These businesses are the toughest to run. They need proportionately more working capital than do larger businesses.

An average business does about 120-180 calls a year. These businesses will need less working capital than a small business, as they serve about 10-15 families a month. While they may have a week without calls, odds are they will have days with multiple calls.

A business serving more than 180 calls a year is deemed a large business. A large business needs the least amount of working capital. This includes the many businesses with 300 or more calls in a year.

Size of Your Overhead

There are two types of overhead categories: fixed and variable. Variable is easy to understand – the expense does not exist unless a call comes in that requires a product or service to be provided. Caskets are variable costs. A third-party crematory is a variable cost.

Buildings, autos and full-time staff are fixed costs. Fixed costs typically don't change regardless of how many calls you perform. The cost of your building is the same whether you serve 100 or 300 calls a year. Repairs on the building and utilities change depending on the building's use, but your real estate taxes and mortgage don't change.

You must compute the amount of your fixed and variable costs of operation two ways: per call and per diem. The per-call analysis takes each of the cost categories and divides them by the budgeted amount of calls.

For example, assume that the fixed costs of your business are $500,000 and you serve 200 families. Your fixed costs per call would be $2,500. In the same regard, assume your variable costs are about $200,000, which equates to about $1,000 per family. Added together, it costs you about $3,000 to serve a family.

If you serve 210 families instead of 200, it will cost you only $1,000 per family, the variable costs per call for each of the 10 you do above your anticipated budget. We call that accretive revenue. The profit on those 10 extra calls might be 80% of revenue!

The second way to look at your overhead is on a per-diem basis. What does it cost to be open for a typical day? Using the example above, with a $700,000-per-year overhead (fixed + variable costs), you have a per-diem overhead of about $2,000 (divide total overhead by 365 days).

Once you know your per-diem overhead, you can now determine your working capital needs. The small business should have at least 90 days of overhead in working capital, the average business about 60-75 days of overhead in working capital and the large business about 30-45 days of overhead in working capital.

Good Receivables

You need to break your receivables into three categories: good, probably good and I just pray on that one.

It's easy to define the two extremes. For example, "good" receivables are those backed by a verified insurance policy or your preneed. It is not a question of *if* you get paid, only *when*. "I just pray on that one" are those with families that promise to pay. All within that group assume they are not going to get paid and rejoice when they do. "Probably good" are those in-between.

For the sake of this exercise, only count the good and probably good. Working capital is cash + good receivables. Now, let's go through the three tests to determine if we have enough working capital.

DETERMINING WORKING CAPITAL

Test 1: Accounts Receivable

In a practical world, your total accounts receivable should never be more than 11% of annual revenue. So, if your revenue is $700,000, then accounts receivable should not be more than $77,000. At this ratio, your accounts receivable are about 42 days of your total sales, which means the average family pays you in 42 days (11% of 365 days).

Test 2: Days of Overhead

Compute your working capital and divide it by the per-diem overhead. That gives you the number of days of overhead you have in working capital. Again, as stated, a small business needs about 90 days of overhead, an average business about 60 days and a large business about 45 days of overhead. Anything less than that and you will not be sleeping well.

Test 3: Current Ratio

Create a fraction. The numerator is your working capital and the denominator your current liabilities (from your balance sheet). Regardless of the size of your business, you want to have about $2 of working capital for every $1 of current liabilities.

Next Steps

What do you do if your working capital is below where it should be? The only ways to raise cash in your business are to increase profit or loan the business some of your own money. Unless circumstances are dire, I do not recommend the loan. You do have several options: raise prices to raise profit, keep prices the same but cut overhead to raise profit or get a line of credit from a bank to be used only when your working capital falls below any of the above test marks.

Do not try to refinance your business to raise working capital. Your problem is a behavioral problem, not a financial problem, and borrowing will just increase your overhead and the need for *more* working capital.

What do you do if you have more working capital than you need? That's easy – gift it to your favorite business writer. We writers and editors all took an oath of poverty, so this gift can help us eat during the cold winters. As an alternative to this first idea, take it out of your business and invest it for your future.

Should you use it to pay down debt? No. That is as silly as sending it to me! When you pay down debt, you increase the value of your business $1 per $1. If you use it to invest, maybe you earn more than your interest on any loans, and that will grow faster than paying down your debt. I know you hear people on the radio saying, "Debt is bad," but that's why they're on the radio! They don't know how to run a business.

Tear down the idea that still having checks means you can still spend money! We must rebuild your business, and I look forward to preparing you so that your 2020 Vision is crystal-clear.

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