

Be Financially Prepared for a Business Changing Event

July 2012, by Yolander Prinzel

No matter how many projections you run, business is ultimately unpredictable. There are many extraneous factors over which you have no control. You can however, proactively prepare for these factors by ensuring you have a cash cushion and emergency operations plan.

Conventional wisdom on cash cushions matches that for personal emergency savings: set aside three to six months of operating costs. When estimating those operating costs, include all your employee payroll expenses, marketing and business continuation costs. The savings can be set aside in any number of conservative, easily liquidated, interest-bearing accounts, such as money market accounts, although a business might also consider laddering CDs with various maturity dates.

Why Your Business Needs a Cushion

Sometimes small business owners, especially those operating as an owner-employee out of the home with few overhead costs, assume they can avoid the creation of an emergency savings for their business. But any company, regardless of size, could run into payroll-halting problems such as:

- Product recalls
- Rebranding needs
- Late-paying clients
- Lost clients and distributors
- Cash flow issues after a delayed contract or during project bidding
- Regulation and legal changes that force a business to cease operations until compliant

Balancing Savings and Debt Payments

While you might be more focused on paying down debt than accumulating savings, the real struggle should be balancing the need to do both.

Action: The first step is to determine whether your company's debt creates revenues that exceed its interest rate. For debt that does, there's no immediate need to aggressively pay it down. For debt that doesn't create revenues that outpace interest expenses, accelerating repayment is a smart move as long as you can also build your cash reserve.

The way you balance your operating costs, debt repayment and savings will depend greatly on the revenue

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your business generates, your future business goals and the accuracy of your future projections. Often, meeting with a financial planner for the creation of your business plan and budget is a good solution to finding that perfect balance. You might even consider outsourcing the duties of a chief financial officer. See “Choosing An External Account” for further information.

Go Further with an Emergency Business Plan

Creating a cash cushion isn't the only way a business can protect itself from the blows of a sudden downturn. Consider the following action points:

- Purchase the right insurance. While insurance can't guarantee the success of your business, it can pay continuation expenses after an insured disaster and could help you recover from cyber risks such as fraud, data theft and Internet defamation.
Action: For these protections, purchase “business continuation” and “cyber risk” insurance policies.
- Plan for reduced employee hours
Action: Analyze the busiest and slowest times for your business and create a flex schedule for your employees to work if a downturn occurs. This will reduce your payroll expenses without leaving your company unstaffed during crucial hours.
- Prepare to cut costs
Action: Keep a running list of expenses that can be reduced or eliminated without impacting your business severely, such as magazine subscriptions for waiting rooms, flowers for reception or fancy marketing materials. Bear in mind that these small things can add up to big cost savings, but also alter the way your business is perceived, so try to keep changes temporary.
- Consider outsourcing tasks instead of hiring employees to cover them. For more on this see “Five Cost Cutting Ideas To Help Expand Your Network” or watch “Reducing Fixed Costs to Improve Your Bottom Line.”
- Act quickly
Action: Implement budget changes before the hard times hit. If you see a slowdown coming, but haven't yet felt the financial effects, reduce your business spending immediately and start protecting your cash position. For more on this see “Why Knowing Your Business's Near Term Cash Position Is Important.”

You haven't just poured your savings and working hours into your business; you've poured your hopes and dreams into it too. Protect your business and your future by creating a robust cash cushion and developing a financial contingency plan so you have a better chance of emerging unscathed from a business-changing event.

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