

# Why **cash** is more important than profit

By Roland Hanekroot

## What do you really need to know in order to put your retail business on a solid financial footing?

When coaching business owners, I often find that their key financial objective is all about profit. Funny as it sounds though, profit is not the purpose of business. Business can't exist without profit but it isn't the reason the business exists.

To manage the finances of your business, there are three important principles to understand:

- 1) The reasons for making a profit
- 2) Understanding that profit and cash is not the same thing at all
- 3) Your focus should be on cash - not profit

### Why profit?

The truth is that we only need to make a profit in order to:

- Ensure our investors and stakeholders get a good return on their investment
- To provide the business with funds to invest in itself and grow
- Provide an indicator of how well we are doing in running the business.

### Profit and cash

The trouble is, many people seem to think that profit and cash is the same thing and that brings a lot of business owners unstuck.

Remember, profit is only a simple sum (on paper) of sales minus costs. So if you sell products in a week for a \$100 and it costs you \$50 in raw materials and \$25 in office costs, it means that you have made \$25 profit that week.

So far so good... but in most small businesses (including yours), the bank balance bears little relation to your profit number. In reality, you may not be paid for the \$100 of product you



sold that same week. In addition, you may have had to pay for costs from the previous week or month. Business costs such as rent, purchase of goods and staff wages often have to be paid long before your profit actually hits your bank account. Therefore, in reality, at the end of the week your bank account may be in the red, even though you have actually made a profit.

### Cash flow

So we can't just look at a single number, our bank balance, to work out how the business is going. Profit is a nice simple number, and if the number today is bigger than the number was yesterday, it means we are going in the right direction. Measuring the cash position of your business is trickier.

When thinking about cash, it is useful to think in terms of flow, money flowing in and out of your account, like a river flowing into the sea. If more money flows into your bank

account in a given period than flows out in that period, your bank account swells!

### Cash is the main thing

That brings us to the third and final principle of financial management: Cash, not profit, must be your first priority because *only cash can be used to pay for stuff*.

Theoretically, your business may never make a profit and yet survive, as long as you continue to have enough cash to pay the bills (obviously you need to start making a profit at some stage, or the business will run out of cash in the end).

So, as a business owner who is committed to put his business on a solid financial footing, cash must always be your king. ■

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