



ProMACSM

Professional Martial Arts College

Session 9A, Section # 5

Pro-MAC National Section #6

Wealth Management

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TOPIC 1 – CASH FLOW MANAGEMENT

I. What is Cash Flow Management?

This discussion is closely linked to the discussion we had last session about Projections, and the need to evaluate and know your numbers. It is also linked to a basic understanding of Financial Statements. Remember our prior discussions of Financial Statements. There are four basic statements that are created from your historical numbers. They are a Balance Sheet, an Income Statement, a Cash Flow Statement, and a Statement of Stockholders Equity. There are also footnotes which describe the numbers and the principals and procedures used to get to the numbers. A balance Sheet is simply a Snap Shot of your company at a given time. It lists the assets, the liabilities and the stockholders equity (the amount left after subtracting the liabilities from the assets). The Income Statement specifies what your revenue and expenses and profit are for a specified period. A Cash Flow Statement shows what net cash is coming in (after regular expenses seen on the Income Statement) and what is going out for capital improvements etc. In addition to showing net cash inflows from operations, it also shows money from other sources such as banks etc. It is designed to give the user an understanding of cash in and out and what is being spent on capital improvements etc. The statement of Stockholders Equity described the equity dollars that have come into a company and the amounts added from profits left in the company, and the amounts which have reduced it through distributions or dividends.

Often times we find ourselves caught off guard with an unexpected cost in our business and insufficient resources to pay that cost. While this can be the result of an unexpected outside influence (hurricane; injury, etc.), more often than not, it is the result of poor planning and analysis by the business owner. Cash Flow Management can be defined as simply the



ability to know what revenue can be counted upon and when, and what costs are likely to occur and when, and managing the timing of those events. Seldom do big inflows of revenue come in at the same time as the required outflow of expenses. The most common tool for managing the timing of cash flow is a bank line of credit. For those who prefer not to borrow money, there is always the option of building up cash reserves to pay expenses as they become due. Building up cash reserves is something that is often easier said than done. Proper cash flow management can improve your ability to build up these reserves (or take them as personal income). Other things are also commonly done to cover unexpected expenses, such as purchasing insurance.

By understanding your cash flows you can reduce the risk in your business and better achieve consistent positive cash flows. Planning is critical. For instance, you should know that you are going to have to pay insurance every year and you should prepare for that event by putting aside money each month to be ready to pay it when it comes due. This planning also allows you to save money by taking the time to investigate and determine what insurance is going to provide you the greatest coverage at the best cost. As a business person who also happens to be a martial artist, you need map out your cash flows (i.e. create a well thought out budget) ---the same way you map your curriculum to get your students from white belt to black belt.

We would strongly recommend that, after you have worked through this Cash Flow Management Section, you go back and re-read our section on projections and build out your projections (if you haven't already!).

II. Understanding a Capital Expenditure versus an Expense

Most of us intuitively understand the difference between a capital expenditure and an expense. A capital expenditure is a cost that adds future value to the organization and gets amortized over the useful life of



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that expenditure. Leasehold improvements are a good example of a capital expenditure in the Martial Arts business. Let's say you spend \$30,000 on building out your location after you have signed a new five-year lease. Assuming the money you have spent will likely last the five year term of the lease you would amortize that expenditure over the five years. You would put the \$30,000 on your balance sheet as an asset and reduce that by \$6000 per year in each of the five years. When you take \$6000 off your balance sheet, you add it to your income statement as Leasehold Amortization or Leasehold Depreciation expense. (Don't get caught up in words, different accountants will call this something different; but, you can tell what it is by their description.). Other Examples of Capital Expenditures are computer equipment, vehicles, and work-out equipment purchased for your dojo (rather than purchased for resale).

An expense is something that is consumed when spent and generally does not have a useful life after it is paid. Your two biggest examples will be payroll and rent. (One can argue that your rent payment made for next month is a capital expenditure to be used over the next month, but the useful life is so short that it is considered an expense).

Keep your understanding simple to start with. Don't worry too much about which category the item falls in as it can get confusing at first. For instance, if you prepay your insurance for the next year---is that a capital expenditure to be amortized over the next year or is it an expense? You would think that the fact that you paid it in January and it has a useful life over the next year would make that a capital expenditure. However, it is simply a consumable that you prepaid per the requirement of the insurance company, so it would be classified as a Prepaid Insurance Expense. You would therefore show an asset in January of Prepaid Insurance Expense on your Balance Sheet of \$1,200 (assuming this is the amount paid) and you would reduce that on the Balance Sheet each month by \$100, and move that \$100 to an expense on the income statement), it is nevertheless considered a necessary expense of the

business which is consumed within the year and therefore an expense of the business.

The important thing to understand is that you have “one-time” expenditures and “ongoing expenditures” and PLAN for them. As you evaluate whether something is an expense or a capital expenditure, you will begin to prioritize where you spend your limited money to provide the best “return on investment.” You may decide to defer the car expense that allows you to drive a Lexus so that you can have money to make some capital expenditures on the business so that you can enhance student experience and increase revenue next year. Drive the VW this year (an expense) and buy the Lexus next year, after you begin to see the returns on the Capital you have expended.

III. Know Your Numbers

This cannot be overemphasized. Most business owners have a pretty good sense of the revenue and expenses. This is NOT what we mean when we say “Know your numbers.” We mean REALLY know your numbers. That means investing the time evaluating each category of revenue, and each item of expense. That means knowing how much you bring in each month from tuition, how much from retail, how much from other programs. That also means memorizing your recurring expenses like rent and payroll. It means understanding what additional triple net obligations you have to your landlord (and if you are your own landlord, you should have the property held in a separate entity and the school should be paying it rent). You should know what insurances you have and how much they cost and when they are due. You should know what you are paying for your retail items and the required terms for payment.

To be really good in your business you need to spend the same amount of energy studying these numbers as that which you would spend studying

for a black belt in your martial art. And the studying should not end after you spend the first 100 hours. It is an ongoing process. Our management team spends several hours EVERY WEEK, getting a better handle on both our historical numbers as well as our projections for the current month. We look at which costs appear to be in line with expectations and those that appear to be out of line with expectations. Speak to any successful school operator and they will tell you that they spend a part of EVERY day looking at the numbers. Would it surprise you to know, that in spite of having “numbers guys” as partners, Dave Kovar spends a part of each week getting underneath our numbers. While you tend to see his passion on the mat, he has an unbelievable understanding of the numbers and a passion for knowing them. If the spending the time every day or at least every week getting to know your numbers is something you loathe, we have two suggestions:

1. Get over it, if you expect to become a good operator and make significant improvements in cash flow. It is a must!
2. Consider a business partner (or find one of your partners, husband or wife) that enjoys this aspect.

If you want to generate higher cash flows it is a must. It is an essential part of the “business” part of running a martial arts business.

IV. Stare and Compare

This is really just a further emphasis of “Know Your Numbers.” When you create your financial statements, you must make sure that you put percentages along side of the numbers so that you begin to see not only the numbers, but the relative percentage of revenue that number represents. For instance, in a mature school you will generally find that Occupancy Costs (rent plus triple nets etc) will be between 12% and 22% of total revenue. By understanding the relative percentages, you will be



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quick to know when something appears out of line. Look at (stare) your numbers each month and compare them with last month (as well as the same month last year) to see how they stack up. Look at each line item against the prior periods and see if they are up or down as a percent of revenue. It will help you know your numbers.

As you “stare and compare” you will find things that you hadn’t thought of in the past. For instance, in helping one school owner we found that there was unusual “shrinkage” in the retail inventory. The result was that an employee was terminated and the shrinkage was stopped!

V. Manage your Cash Flow

Once you begin to manage by the numbers you will find that your business becomes much more efficient and profits will improve. By knowing that a large payment is coming due, you can manage to it. A sale or other revenue generating maneuver can create extra cash if planned for properly. Providing a bank line that can be drawn upon if necessary can help. We strongly discourage borrowing to take care of “yesterdays problems” unless you have spent the time building a sound path to paying back that loan so that it can be used on a short term basis to smooth out the ebbs and flows in the business collections and payment process. Again, this takes you back to building a projection so that you can guide your business, rather than react to current circumstances.

It is no different than managing a white belt through to black belt. The same way you are patient with the new student who is not familiar with the system, you need to show yourself the same patience as you begin to develop your business acumen in this area. It takes many hours, days, weeks, and years to get good at managing by the numbers. Be patient, but be persistent. There is no substitute for spending the time. Remember, everyone starts as a white belt!