Managing cash = success

By TONY OLSEN
Director, Flor Hanly & Associates

BEING successful in business is all about managing cash flow. You can read and study all you like about how to be financially successful but the formula is really very simple: "What goes out must be less than what comes in".

As primary producers are largely price takers it figures that what comes in can only be controlled so far. Improving what comes in requires focusing on maximising production and trying to market your product as best you can.

The secret then as I see it is controlling what goes out. It doesn't seem to matter if you have 100,000 acres or only 100, it seems there is always something to spend every last dollar on.

Controlling and limiting this spending to less than what is coming in is what will allow your operation to survive and hopefully succeed.

Operating costs can only be controlled so far before you will start to affect both short and long-term production.

For example choosing not to spend on maintenance now could be very costly in the long term.

Outlays that can cause great cashflow stress are income tax, debt management and capital expenditure.

It's human nature to want to pay debt off as fast as possible.

However, you need to remember that cash used to reduce debt (principal reductions not interest expense) is not tax deductible. Debt reduction needs to be made with after-tax dollars.

The faster you repay debt the more tax you will pay, which will then trigger PAYG for the following year and a cashflow problem!

Not only will you have a cashflow problem, you will most likely be paying much higher rates of tax than you need to, *and* the money will be gone and not available to help you through the next tough year.

Instead focus on your "balance sheet" or net wealth.

This is best illustrated with an example: Jack and John are neighbouring grain growers.

Both have $1 million in debt and have had an excellent season, making $500,000 taxable income each.

Both need $100,000 of income to live on etc. Jack uses his $400,000 to reduce his loan.

The tax man puts his hand out for $179,600 (tax on the $400,000) leaving him with a reduced debt of $779,600.

Jack will also have to find funds for the following year's PAYG, probably another $179,600, which may mean he ends up only reducing his debt by $40,800.

John on the other hand puts his $400,000 in a farm management deposit.

John does not have to pay any tax on the farm management deposit.

John's debt hasn't changed but his "balance sheet" or net position is $600,000 debt, i.e. he has a liability of $1 million on one side and an asset of $400,000 on the other.

> Do whatever you can to maximise what comes in and be careful with what goes out.

Not only is John instantly wealthier than Jack, he is also in a far better position to fund a bad year down the track. The money Jack has used to pay his tax has gone for good.

The same balance sheet approach can be used for equipment purchases. Following on from the above example both Jack and John need to buy a new tractor for $100,000.

They are doing this because they need the tractors, not for tax deductions. Jack chooses to pay cash for his.

What he doesn't realise is that capital expenditure is not tax-deductible when purchased. He has to first buy it with after-tax dollars.

Over time he will receive some depreciation benefits to gradually recoup his expenditure but this doesn't help this year's cash flow.

John on the other hand knows he needs to keep his cash for farm management deposits to reduce tax (cash outflow).

He finances his tractor with equipment finance to allow him to allocate what cash he has to best position him for the future.

So do whatever you can to maximise what comes in and be careful with what goes out.

Resist the temptation to repay debt rapidly. Instead focus on accumulating wealth.

Paying too much tax is very detrimental to cash flow and business survival.

For those of you who have filled your allowed farm management deposits, well done and good on you!

You now need to look at your structuring to make sure you can get a similar result to FMDs using different tax structures.