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The bottom line on cash flow

Why adequate cash flow is essential to an agency's success

By Barry Kehl

We often hear about the importance of the bottom line. This last line on a financial statement indicates an entity's profit or loss, so the bottom line is a key focus for most businesses.

There's no doubt that a professional, independent insurance agency's profitability is critical. However, cash flow may be equally important to an agency's health. From an internal perspective, poor cash flow can impact the agency's ability to operate. Without a healthy, adequate and consistent cash flow, an agency can find itself out of business. Poor cash flow also can prevent agencies from accessing credit for needed capital. Remember: To a commercial lender, strong cash flow is a good predictor of a business's ability to repay a loan.

After reviewing thousands of cash-flow statements of agencies of all sizes, I've noticed that poor cash flow is often the result of five issues: over-leveraged agencies; over-leveraged agency owners; unpaid withholding taxes; over-invested agencies; and failure to budget.

No. 1: Over-leveraged agencies

Many agencies have excessive debt and the resulting debt payments have a negative impact on cash flow. Agencies take on debt for a number of reasons—some good and some bad. In my review of cash-flow statements, I've noticed that the debt that causes the most problems is the debt accrued for over-priced acquisitions, big mortgages on real estate and enormous credit-card debt used to cover regular operating expenses. To avoid this scenario, agencies should adopt conservative fiscal policies and carefully weigh decisions to take on certain types of debt. Knowing best practice financial ratios for your agency can be helpful to maintain a sound financial status.

No. 2: Over-leveraged agency owners

Sometimes insurance agency owners go overboard when it comes to their personal spending. After they pass the early years and experience more stability and success, they adapt lifestyles that are more elaborate. Expensive mortgages for nicer homes, recreational purchases and activities (e.g., extra cars or boats), pricey vacations and other indulgences necessitate larger salaries that can drain the agency's cash flow. What's more, agency owners in these scenarios often turn to credit cards to support their lifestyle, leading to further debt. Sticking to best practice financial ratios, regardless of a principal's desire for additional money, is the safe route to take in order to maintain healthy cash flow.

No. 3: Unpaid withholding taxes

Withholding taxes may seem like a simple and common business practice, yet many agencies have cash-flow issues because they fail to withhold taxes throughout the year. As a result, they take a financial hit when the tax bill comes due and their cash flow is impacted significantly. Even though it may be tempting to utilize funds that should be set aside for other expenses, it is rarely a good idea. This discipline may be difficult to keep in the early stages when businesses often are cash-strapped. However, to avoid a major cash-flow disruption stick to a plan to withhold taxes on a regular basis.

No. 4: Over-invested agencies

Agencies with cash-flow issues often invest heavily in strategies to grow their businesses, only to see little or no return on their investments. Typically, these investments are in areas such as new producers, marketing plans and technology. This is when knowledge of how to best recruit and compensate the right talent comes into play. In addition, the right compensation structure is critical. Agencies also spend thousands of dollars on leads, but lack a good strategy to develop and capitalize on those leads. Or, they spend too much on marketing technology, believing a sophisticated system is an effective strategy. For example, spending a lot of money on a fancy website doesn't automatically result in quality leads or the new business needed to cover even a portion of the expense of the new system. Worse, some agencies sign contracts to receive services and find themselves locked into payments for services that don't yield guaranteed results. While you do have to invest in growth, be careful and do your homework before making major decisions. Get evidence that investing in products and services will deliver an appropriate return.

No. 5: Failure to budget

The most important business practice: Create an operating budget and stick to it. Most agents enter the agency business because they have an aptitude for sales. They aren't necessarily strong in finance and many never have been exposed to the basics of accounting and business finance. Consequently, they may neglect to monitor and control revenue and expenses. Cash flow suffers when agency owners lack a detailed understanding of the agency's financial condition.

An agency should invest time and resources to ensure its business is in good financial shape and that it has the cash flow to cover unexpected expenses. This will help the agency thrive and provide the best service to its clients. It also will put the agency in a good position if it ever needs to apply for credit, should it need to expand or improve its systems.

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