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How To Establish A Cash Flow Plan With Variable Income

Small business owners may experience income fluctuations throughout their careers, especially in the early stages.

In the seasons of variable profits, how can you create a cash flow plan that works?

Below are four tried and true ideas to help get you started!

Pay Yourself A Salary

It's time to examine the books (either yourself, with your tax planning financial advisor, tax professional, etc.) and answer the following question,

How much money can you "guarantee" for yourself each month?

As a starting point, you may want to err on the side of caution. Being more conservative will allow you to establish more regularity and give you room to grow—maybe you'll even pay yourself a bonus!

How much is "too" much to pay yourself?

The key is to retain a large-enough pool of money inside the business, so you aren't scratching pennies together or scrambling to pay your bills (or your employees). A conservative approach can help you manage business variability and your personal income needs better.

Paying yourself a salary from your business brings predictability to your income and helps keep your business and personal dollars separate.

When it comes to cash flow, sometimes keeping it simple is the best approach. Think through the following questions:

Are you spending more or less than you bring in each month?
Do you have room to invest for retirement?
Do you have a personal and business safety net?
Can you reinvest profits into your business?

Start by tracking your personal checking account balance—if you're not spending more than you make, you're in a great spot!

Know Your Expenses—All Of Them. Bonus: Be Flexible

Remember, we're talking personal expenses here, not business expenses (those will come out of your business account).

Here's an excellent place to start:
Housing
Food
Utilities
Internet
Transportation
Debts
Insurance
Taxes
Entertainment
… and other core living expenses

While some of these costs may be predictable month to month, like your mortgage payment, others may vary, like food or utilities—natural gas costs tend to be higher in the winter, for example.

It's also common for costs like insurance premiums, cable and internet packages, and other utilities to increase each year, but you can negotiate these expenses. Yep, you can haggle with your cable provider, utility provider, even your insurance carrier. Especially in the case of auto insurance, internet, TV, and cell phone providers, it may make sense to switch companies every couple of years to maintain the best rates.

Automation is fantastic for investing, but putting these costs on autopilot could leave you paying more than you need to each month. If you can really save hundreds of dollars on your insurance, you could redirect your savings to retirement, brokerage account, or other goal buckets.

To help, track your expenses each month. Doing so allows you to identify trends in your spending, can help you spend with more intention, and give you the motivation to stick with your cash flow plan long-term.

Lifestyle Creep And How To Avoid It

As your income grows, be mindful of “lifestyle creep” or living above your means. This could look like buying a super fancy car you can’t really afford, buying “too much” house to handle, spending on material things that don’t align with your goals and values, etc.

It’s so easy to give in to this temptation as you start earning more money. When you see a larger paycheck, you may want to treat yourself to the more expensive groceries or not worry about your cash flow plan as much since you feel like you can “splurge” now that you have extra funds.

How can you live within your means happily?

Use your money in ways that align with your goals, values, and priorities. While that may sound easier said than done, think about why you use money. Below are some examples of financial why’s:

Buying a house allows you to build equity, grow your family, and give your kids access to the best school district.
You started a business to craft a career you love, serve the community, and provide for your family.
Investing in your retirement accounts opens up opportunities in your golden years.

When you know your why, you’ll be able to understand how much is “enough” for you to live a fulfilled life.

Once you have that number, focus on saving and investing the rest.

The fast-pass to wealth is to bring in more than you spend and invest any leftover funds. When you receive a large amount of income during good business years, it will be worth it to store the funds out of sight and out of mind and build your nest egg.

Create A Healthy Safety Net

Business owners with irregular income should amass a proper emergency fund to protect themselves in periods of lower profits.

Your emergency money should be accessible, liquid, and kept in a high-yield savings or money market account. As a general rule, it's often best to keep anywhere from 3 to 6 months' worth of living expenses on hand.

However, it may make sense for a business owner to be even more conservative in your cash reserve by having 3-6 months of personal expenses and another 3-6 months of business expenses—so two separate emergency funds. If your income is exceptionally variable, like in a seasonal-driven business, you may want to gravitate closer to the 6-month buffer.

But the amount in your emergency fund may also be influenced by your spouse's employment. If you are the sole income earner and your self-employed business is variable, consider having 9-12 months of expenses in an emergency fund.

If you have seasons of more significant liquidity needs, you could also explore a home equity line of credit. A HELOC allows you to tap your home's equity for upfront costs. You will need to be mindful of interest rates and repayment terms, but it could be a good option to keep in mind.

Keep Investing For Your Future

As a business owner, you take on the full responsibility of funding your future goals like retirement.

Ensure that you build those savings into your monthly cash flow plan. Whether you're saving in a Solo 401(k), SIMPLE IRA, SEP IRA, or another retirement account, create a plan to invest each month. Even more, automate your savings if possible (behavioral finance tip).

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A healthy way to consider competing goals with different time horizons is to separate your accounts into liquidity buckets. Buckets could include the following:

Business emergency fund
Personal emergency fund
Invest a sizeable amount into a taxable, moderately risky account that you can access should you need it in a bad year but can still grow in the meantime.
A retirement account for longer-term growth for funds you won't need for a while.

Have you been able to save in a Roth IRA? Business owners may not know that these funds offer some accessibility for short-term needs. You can tap your Roth IRA contributions (not your earnings) tax and penalty-free if the account is at least 5 years old.
Are your cash flow plan and investment strategy comprehensive and ultimately aligned with your financial plan? Learn more about how we can help you today! Please contact us for more information.

Reserve Your Spot On The Calendar

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Craig Toberman is a Partner at Toberman Becker Wealth – a fee-only, fiduciary financial advisor based in St. Louis. He assists families and businesses with strategic financial planning and long-term wealth management. He has over a decade of experience in financial services and has crafted custom financial plans for hundreds of families and businesses.

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