ILLUSTRATION: SUDHIR SHETTY

Irregular income? Manage your money with a steady plan

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One of the common complaints we hear from entrepreneurs is that they do not have a surplus to invest for their personal goals as they invest all their money in business. Besides, since they do not have a regular income, they cannot really invest like salaried individuals do.

When we converse with them to understand what truly matters to them, they realise that they also need to plan for regular personal finance goals such as sending their children to the best college, buying houses that they would truly like to call home, or going for foreign vacations every year.

The challenge on lower predictability of cash flows is something I relate to. So how does one really build a robust personal financial plan despite an irregular income?

Look for patterns in cash flows: While the world has moved to big data analytics, we think that entrepreneurs need to do something much simpler—closely look at their cash inflows and outflows for the past two years. Invariably, especially for mature businesses that are more than three years old, we find that a pattern emerges of a fixed cash inflow and a variable cash inflow. Expenses also tend to have a fixed component and a variable component. Thus, net cash flows tend to have both a fixed and a variable component. Being able to separate these requires some effort, but it is worth it.

This separation allows the irregular cash flow to be separated into a regular cash flow and a truly irregular cash flow, somewhat like a variable component of a salaried employees' compensation.

Pay yourself first: Many entrepreneurs tend to pay themselves last as they are not sure if there will be enough. We think this is a terrible idea – after all, it prevents an entrepreneur from bringing capital back into the business. One of the best ways to address this fear of running out of money to manage operating cash flows is to create a contingency fund to support three to six months of cash flow needs. This can be parked in a liquid mutual fund, or if the entrepreneur has credit facilities, in an overdraft account to reduce interest costs.

It is ideal that the entrepreneur pays himself a competitive market salary for his qualifications..

Avoid investment choices that lock in capital: We come across entrepreneurs who have multiple investments in life insurance policies or real estate—investment choices that tend to be rather illiquid and are also not very flexible. The key to a successful investment strategy is to have flexibility to allow complete or partial withdrawals easily and without significant costs. They should also have the flexibility to start and stop when needed.

Thus, the use of instruments such as open ended mutual funds and bank deposits are good alternatives to look at.

Use quasi regular investment strategies like STPs: Systematic Investment Plans or SIPs have become very popular, but a lot of entrepreneurs stay away from them as they do not have regular cash flows. A good alternative for them to explore is a Systematic Transfer Plan (STP), wherein, the surpluses can be invested in a liquid fund, and the money can be moved from a liquid fund to an equity or hybrid fund on a monthly basis to get the benefit of buying each month just like an SIP and averaging the costs of purchase.

Adequate health insurance: For entrepreneurs already challenged by irregular cash flows, an unexpected outflow owing to health care costs is a critical setback.

Having a business with irregular working hours and staying connected 24X7 is challenging enough. Adequate health insurance is a must.

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