

# Cash Flow Management

Concepts to consider when managing your business cash flow



Every business will experience tough times. Small businesses are especially vulnerable because their management resources are usually thin, and they lack the tools to predict difficulties, and identify available remedies.

It is important to try to look ahead and see the potholes on the road. What if you lose your biggest customer? Are you overdependent on too few customers? What does your order pipeline for the coming months look like? Are you maintaining tight expenditure controls to minimise the risk of overspending?

Also, if you experience a strong recovery after a slow period, there are even greater dangers. For example, working capital is required to build stock, which must be paid for before your customers pay you. So just when you think things are OK, you hit the buffers.

Always watch  
your cash flow –  
good and **bad**

# The Three 'c's – to manage cash flow



Cash



Credit



Communication



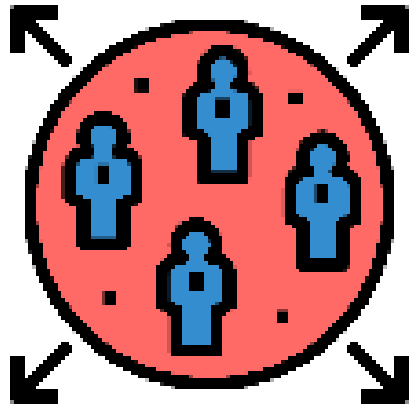
# Cash

- Effective cash management is good housekeeping that ranges from controlling your number of employees, through keeping tight clamps on all expenditure, to the nitty-gritty of finding cash where you least expect it. For example, you may be able to encourage people who owe you money to pay more promptly.
- Or you could factor (Invoice Discounting) your outstanding debt invoices via companies that take over your debt collection while paying you immediately, less a small charge for buying your risk.
- And if you have invested heavily in developing new processes or a new product or service, it may be possible to tap into relatively unknown Research & Development Grants available from government agencies.



# Credit

- It may be possible to agree deferred payment measures with your creditors. Simply hiring a good credit controller (part-or full-time) may reap rich rewards.
- If you have maintained good relations with your suppliers, this may be an easier challenge than imagined as they have a vested interest in your sustainability.
- What is required is a workable credit control plan to manage payments in and payments out, and this in turn requires a vital third element...



# Communication

- ‘It’s good to talk’ – all too often, business owners think it is best to cover up their difficulties for fear their customers will hear about it. The reverse is true. It is far better to discuss your situation with those who might be able to support you. For example: Your bank, suppliers... and customers.
- It is better to explain the measures you are taking. Most people understand the challenges you are facing only too well, because they may be facing similar challenges. You may be able to find better solutions through collective action.
- You are less likely to lose staff if they know what is going on. They like to know that management is controlling the situation and how they can help.

# Financial reporting



- No matter how small your business, it is essential to review monthly financial statements showing sales, cost, profit, and cash. The routine of a monthly review meeting also provides a good forum for effective communication.

# Improving receivables



If you got paid for sales the instant you made them, you would never have a cash flow problem. Unfortunately, that doesn't happen, but you can still improve your cash flow by managing your receivables. The basic idea is to improve the speed with which you turn materials and supplies into products; inventory into receivables; and receivables into cash.

**Here are specific techniques for doing this:**

- Offer discounts to customers who pay their bills rapidly.
- Ask customers to make deposit payments at the time orders are taken.
- Require credit checks on all new non-cash customers.
- Get rid of old, outdated inventory for whatever you can get for it.
- Issue invoices promptly and follow up immediately if payments are slow to come in.
- Track accounts receivable to identify and avoid slow-paying customers. Instituting a policy of cash on delivery (c.o.d.) is an alternative to refusing to do business with slow-paying customers.





# Managing payables



Top-line sales growth can conceal many problems – sometimes too well. When you are managing a growing company, you must watch expenses carefully. Don't be lulled into complacency by simply expanding sales. Any time and any place you see expenses growing faster than sales, examine costs carefully to find places to cut or control them.

**Here are some more tips for using cash wisely:**

- Take full advantage of creditor payment terms. If a payment is due in 30 days, don't pay it in 15 days.
- Use electronic funds transfer to make payments on the last day they are due. You will remain current with suppliers while retaining use of your funds for as long as possible.
- Communicate with your suppliers so they know your financial situation. If you ever need to delay a payment, you'll need their trust and understanding.
- Carefully consider vendors' offers of discounts for earlier payments. These can amount to expensive loans to your suppliers, or they may provide the chance to reduce overall costs. The devil is in the details.
- Don't always focus on the lowest price when choosing suppliers. Sometimes more flexible payment terms can improve your cash flow more than a bargain-basement price.

# Managing payables



- You can often get extended terms that amount to a hefty, low-cost loan from your suppliers just by asking. That's especially true if you've been a good customer in the past and kept them informed about your financial situation.
- Consider using factors (Invoice Discounting). These are financial service businesses that can pay you today for receivables you may not otherwise be able to collect for weeks or months. You'll receive as much as 15% less than you would otherwise, since factors demand a discount, but you'll eliminate the hassle of collecting and will be able to fund current operations without borrowing.
- Ask your best customers to accelerate payments. Explain the situation and, if necessary, offer them a discount of a percentage point or two. You should also go after your worst customers. That is those whose invoices are more than 90 days past due. Offer them a steeper discount if they pay today.
- You may be able to raise cash by selling and leasing back assets such as machinery, equipment, computers, phone systems, and even office furniture. Leasing companies may be willing to perform the transactions. It's not cheap, however, and you could lose your assets if you miss lease payments.
- Choose the bills you'll pay carefully. Don't just pay the smallest ones and let the rest slide. Make payroll first as unpaid employees will soon be ex-employees. Pay crucial suppliers next. Ask the rest if you can skip a payment or make a partial payment.



# Important cash flow basics



- So, what *is* cash flow?
- It's basically the movement of funds in and out of your business. Typically, businesses track cash flow either weekly, monthly or quarterly.
- There are essentially two kinds of cash flows:



# Cash flow basics



- **Positive cash flow:** This occurs when the cash entering your business from sales, accounts receivable, etc. is more than the cash leaving your businesses through accounts payable, monthly expenses, employee salaries, etc.
- **Negative cash flow:** This occurs when your outflow of cash is greater than your incoming cash. This generally means trouble for a business, but there are steps you can take to fix the negative cash flow problem and get back into the positive zone. Cutting business expenses is one of the quick fixes.

**These critical numbers tell you just how much is coming in and how much is going out of your business. Making more than you're spending? It's all good. Cash flow regularly edging into the negative zone? Not so good.**



# Profit does not equal good cash flow



- You can't just look at your profit and loss statement (P&L) and get a grip on your cash flow. Many other financial figures feed into factoring your cash flow, including accounts receivable, inventory, accounts payable, capital expenditures, and taxation.
- Effective cash-flow management requires a laser focus on each of these drivers of cash, in addition to your profit or loss. The rules of accounting define profit simply as revenue minus expenses. However, a smart business owner understands that earning a profit is not the same as knowing what happened to your cash.




# Find your breakeven point



- You should know when your business will become profitable, not because it will affect your cash flow — because it won't — but because it gives you an early goal to strive for and a ready-made target for projecting future cash flow. Negative cash flow and negative profits make for a grim combination. Focus your efforts on managing your cash flow with a view to reach the moment when you realise your first profits.



# You can't control what you don't measure



Determining the amount of working capital your business needs to operate is the first step.

**You need to answer questions like:**

- How much inventory do I need to hold?
- How many invoices are overdue?
- How much cash is tied up in work in progress?
- How long does it take from paying our suppliers for the materials to extracting cash from the customers?



# Tips to fix cash flow problems in your business

- Now that you have a fair idea about cash flow basics, lets see how you can find solutions to cash flow problems:
- **Short-Term Financing**  
Short-term financing such as a line of credit can be used to make emergency purchases or to bridge the gap between payables and receivables. Many financial institutions issue business credit cards that you can use to pay your vendors.
- **Long-Term Financing**  
Large asset purchases, such as equipment and real estate, should usually be financed with long-term loans rather than with your working capital. This allows you to spread the payments over the average life of the assets. You'll be paying interest, but you'll have preserved your working capital for business operations.





# Liquidate cash tied up in assets

- Do you have equipment you no longer use or inventory that's becoming obsolete? Consider selling it to generate quick cash. Idle, obsolete, and non-working equipment takes up space and ties up capital which might be used more productively. Equipment that has been owned for a longer period will usually have a book value equal to its salvage value or less, so a sale might result in a taxable gain. This gain should be reported on your tax filings. If you must sell below the book value, however, you will incur a tax loss which can be used to offset other profits.
- Excess inventory can quickly become obsolete and worthless as customer requirements change and new materials are introduced. Consider selling any inventory which is unlikely to be used over the next 12 months (unless the costs to retain it are minimal and the proceeds from a sale would be negligible).



# Create a separate bank account for your business

**A common mistake associated with running a business – especially among start-ups – is mixing business and personal bank accounts and credit cards. Since initial financing often comes from the owner’s personal savings, it’s easy to see how that can happen.**

- Its strongly advised to have a separate bank account for your business. You can ask your bank to issue a credit card, make business-related purchases on that card and pay using your company account. Most credit cards provide management reports that detail the types of purchases made over the month and over the past year. This type of information can then be used in your cash flow budget for the next year.
- Accounting software allows you to import bank statements for reconciliation. This saves a lot of time and eliminates human errors.

# Monitor your inventory efficiently



Analyse inventory movement to determine which items are selling and which ones are duds soaking up your working capital. Try to keep inventory levels lean so your working capital isn't tied-up unproductively and unprofitably.

# Always keep buffer money



Once you find the breakeven point as discussed earlier, you must ensure your business has enough cash to fund your working capital needs. It is advisable to keep three months worth of outgoings in the bank for a rainy day. That may be a thing of the past, but if that's the case with you, make sure you have a buffer of some sort. It can either be personal funds available or an overdraft or revolving credit facility.

# Cut costs, control cash outflows



The best way to control cash flow is to stay on top of your expenses. When you start making profits, you often tend to ignore cost cutting opportunities. Unmanaged outflow could be a silent business killer.



# Keep your cash growing



Keep your cash balances in interest-earning accounts available at most banks. In some cases, you might encounter a minimum balance requirement. Interest rates on these accounts are often lower than those of savings accounts, certificates of deposit (CDs), or money market accounts so consider keeping the bulk of your funds in higher-paying accounts and then transferring funds to meet the minimum balance requirement in your interest-bearing checking account (plus the total payments due that week or month).

Avoid long-term certificates of deposit, which lock you in for a specific period, since redeeming them early may cost you interest. Either invest in penalty-free certificates or only that portion of funds which you are not likely to need during the life of the CD.

# Do not focus on profit, focus on cash flow



- Small business owners usually learn one principle early in the life of their business – “cash is king”. Building and keeping an adequate stockpile of cash provides maximum opportunity and flexibility to any business while enabling its owners to sleep soundly at night.
- Without cash, profits are meaningless. Many a profitable business on paper has ended up in bankruptcy because the amount of cash coming in doesn't compare with the amount of cash going out. Firms that don't exercise good cash management may not be able to make the investments needed to compete, or they may have to pay more to borrow to function.



# Thank you

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