prokom

cashflow guide

Prepared by
Neil Falconer,
Printfuture Ltd.

shaping
print to
business

Managing your Cash flow.

No business can afford to ignore its cash flow. Monitoring this is like monitoring your pulse – it's a crucial health check for your business. Indeed, more than a third of SME's cite issues with cash flow as a barrier to their growth. It's crucial to understand what your cash flow is, how to calculate it and how to use a statement to keep on top of things.

What is cash flow?

Cash flow refers to the movement of money in and out of your business in terms of income and expenditure. Ideally, you want to have a positive cash flow – meaning that more money is coming in to the business than goes out. If you have a positive cash flow, your business will be able to settle its bills and invest in growth. A negative cash flow means you'll need to find an alternative source of income to be able to pay off debts.

If you want to work out the net cash flow, you just add up all of your cash payments over a set period (typically a month) and take that away from your cash receipts. It's important not to get too hung up on one particular month, however. Your cash flow can be more accurately judged over a period of three months or more since most businesses will, naturally, have peaks and troughs.

While your turnover might be a nice big number that gives you confidence that your business is doing well, it's the cash flow that offers a better insight into how well your business is managing. As the old saying goes – turnover is vanity, profit is sanity and cash flow is reality.

What happens if you don't keep on top of your cash flow?

Failing to monitor and manage your cash flow properly puts your business at risk and could lead to a range of different problems. Here are some of the main issues you might face:

- **Too much stock**. If you suddenly receive high demand for a product, it's tempting to order a high volume of material to service that demand. However, if that demand then changes you could be left with far too much stock and, potentially, debt from ordering the materials. Ordering too much stock might also leave you lumbered with materials that become obsolete and difficult to sell.

- **Long payment terms**. Lengthy payment terms can often leave you with long stretches of time when no money comes in. Any unseen issues, from a fire at the office to replacing a laptop, can then be problematic due to a shortage of cash while you wait for the money to arrive. There's also the possibility of bad debt, which is when customers do not pay at all.

- **Overspending.** It's very tempting to go on a spending spree when you win a new client – snapping up everything from fancy orthopaedic chairs to an office ping pong table. However, you need to remember that you haven't actually got the money until they've paid you. Spending money that you don't have is never the best idea.

- **Overtrading.** Just as with stock, it's easy to get carried away with your business outlook after securing a big order. Employing more staff or expanding to more locations might seem like a good idea to grow your business, but you need to have the cash flow to back this up. While your profits can vary, your rent and salaries won't, meaning that you need to be able to withstand short-term pressure on your finances if you want to grow your personnel and premises.

Cash flow statement

Given the importance of good cash flow management, it might well help to produce a statement that demonstrates this. A cash flow statemen looks a lot like a profit and loss statement and the balance sheet. It should aim to look at how cash moves in and out of the business. This in turn, allows you to:

- Consider how funds move through the business
- What impact cash flow has on the running of the business
- How payments reconcile with cash balances and values

In essence, you should see a cash statement as a condensed version of the balance sheet that you produce once a year. The end result of your statement should be a 'Net Cash' figure, which is the ultimate figure derived from all the other numbers in your report.

What to put in your cash flow statement?

A cash flow statement should be made up of three categories: operating, investing and financing.

Operating: This is your net income, plus or minus increases or decreases in your current assets and liabilities and expenses.

Investing: This figure reflects any increases or decreases in long or fixed term assets (independent of accumulated depreciation).

Financing: This reflects any increases or decreases in long term liabilities/debt, owners' capital or dividends.

Once you have these three figures, you either add or take them away from your beginning cash balance to get your overall net cash balance.

Why produce a cash flow statement?

As well as giving a summary of how much cash is available for operations, the cash flow statement also details the ways in which the business is generating revenue. In turn, this reveals a lot about how (or, if) growth is taking place, i.e. whether it is through increasing debt, income etc. This sort of information is important if you want to be able to plan ahead. You might even wish to make a forecast, based on how you think changes you are making to the business will be reflected in future cash flow statements.

This statement is a way of ensuring that you are going to be able to pay all of your bills. As a start-up, it might indicate when you need to get an alternative source of finance as you find your feet. While seasonal businesses can use this to track what happens during peak season and quieter times.

If left unchecked, a cash flow gap can create serious problems for a small business. There are, however, ways for business to plug this cash gap and ensure their business maintains a smooth financial ride through the year. In this blog, we take a look at some of the most effective methods.

What is a cash flow gap?

A cash flow gap is the time in between paying out for something and not getting the money back. For example, you buy stock and pay your supplier on day one. You then sell the stock on to your customer, but they don't pay you for 30 days. The time between you paying your supplier and your customer paying you is your cash flow gap.

In more technical terms, your business will experience a cash flow gap if your cash inflows and outflows don't line up.

How to find cash flow gaps

You can find your cash flow gaps using the following equation: *receivables period + days in inventory – payables period = cash flow gap in days.*

Let's explore what each of those concepts are:

The receivables period. This is the average number of days it takes for your customers to pay you. To work this out, divide your accounts receivable (money owed to your business) by your average daily sales (annual sales divided by 365).

The number of days spent in inventory. This is the average number of days' worth of sales you have in your stock. To work this out, you'll need your inventory turnover figure (which is the cost of your sales divided by your average inventory). For your annual number of days, divide 365 by your inventory turnover figure. For the monthly figure, divide 30 by this figure.

The payables period. This is the average number of days it takes you to pay your suppliers for your stock. For this one, you take your accounts payable (money your business owes) and divide it by average daily purchase (annual purchases divided by 365).

Note: for monthly averages just swap 365 for 30 days.

Avoiding a cash flow gap

If possible, adopt the following best business practices to avoid creating a cash flow gap:

- Don't amass too much stock and raw materials
- Don't accept short payment terms from vendors
- Don't forget to invoice customers as soon as possible
- Make it easy for customers to pay you

How can I close a cash flow gap?

Obviously the smaller the cash flow gap is, the better. Once you've worked out the size of your cash flow gap, you can adopt one of the following methods to close it.

Increase the receivables period by offering rewards such as discounts or incentives for early payers, and/or fines for late payers. You may also address this by increasing the number of payment methods you make available for you customers and sending out invoices as early as possible.

Alternatively, you can reduce the number of days spent in inventory with a "just-in-time" stock model through which you hold just enough stock to cover existing order. If this won't suit your business model, then look at negotiating longer payment terms or, if possible, a better price so that you owe less money.

However you choose to address your cash flow gap, you'll need to reduce your receivable period and days in inventory while you increase your payables period. This will help you get cash out of your stock and delay your payments for a long as possible.

How can you cover a cash flow gap?

If possible, you should try and build up a cash reserve so carry your business through any cash flow gaps you face. If you don't have the cash available, then you'll have to source it.

Depending on your credit status, you maybe be able to borrow money from the bank. Alternatively, you may be able to sign up with a finance lender like iwoca.

Iwoca’s flexible credit facilities allow you to borrow up to £150,000 and:

- Borrow any amount up to your credit limit
- Keep the funds for up to 12 months or make free early repayments
- Avoid hidden fees with one simple interest rate
- Sign up in minutes, get approved and funded in hours

KONICA MINOLTA

prokom.org