CASH FLOW IS KING WHITE PAPER

Cash Flow is King White Paper

Executive summary

Like a King is revered by his loyal subjects, so should cash flow be respected by the business owner(s) and staff alike, as it is the life blood of the business, without which the business will die. This white paper looks at how managing cash flow effectively is essential for all businesses of all shapes and sizes. Bowraven's white paper will help you understand the significance of good cash flow management. We also look at the irony in business with regards to arranging bank loans, which is the more you need a loan, the less likely you are to get one. Banks tend to want to throw money at you when you don't need it, but run away when you really need it!

Introduction

Keeping control of the cash flowing through your business is essential for any healthy business. Making sure at the outset that money flows in on a regular basis from customers, by having an efficient invoicing and debtor management system in place is your first key. This will set the stage to make sure you are generating cash to deal with your supplier payments both for cost of sales and overheads, together with your payroll and other monthly cash flow commitments. These can very quickly become difficult if your cash isn't flowing as it should be, so you could end up having some awkward conversations with your suppliers. In this white paper we explore solutions that can help monitor, manage and improve your cash flow, so it never becomes a problem.

Cash Flow

Cash flow is the measure of money flowing in and out of your business at any given time. If your business is profitable and you are on top of your customer receipts, you will have more cash flowing into your bank account than is flowing out. A sign of a healthy cash flow is always having spare cash in the bank, so that you can always pay your payroll and suppliers on a timely basis.

Cash inflows would include: Payments for goods or services from your customers; Interest income from deposit account savings or investments; Bank loans or shareholder investments; Business grants and subsidies; Tax receipts.

Cash outflows include: Payments to suppliers for purchases of stock and raw materials; Payments for business overheads, including rents, rates, telephone etc.; Purchase of assets for the business, for example equipment and vehicles; Wages and salaries together with related government tax payments; Other tax payments, including VAT or sales tax, corporation tax etc.; Loan and hire purchase payments; Dividends to investors.

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Cash Flow Forecasting

A good cash flow forecast will identify all sources of cash flowing into your business together with all amounts of cash flowing out of your business over a chosen period, with a closing balance of cash at bank. Cash flow forecasting requires good planning and the putting together of accurate information. With an existing business, the forecasts should be based upon past data and the assumptions used should also be built upon past performance.

The easier part of preparing a cash flow forecast is working out the cash outgoings. You will know your rent and rates figures, you will have a good idea of your wages and salary costs, you can get a good feel of what your other overheads will be. Also, once you have made a stab at what your sales forecast is, and assuming you know your level of direct costs associated with this forecast level of sales, you will then have your cost of sales numbers.

The more difficult part of any cash flow is to estimate what your sales will be – this is a bit like looking into a crystal ball. The important thing to note is to be realistic and base the forecast on reasonable assumptions. For example, how many leads do you think you will generate from your sales and marketing campaign you have planned and then make realistic assumptions on conversions of those leads into sales. Other elements of cash inflows, like interest income, loans or shareholder investment are much easier to assess and slot into your forecast.

For a cash flow forecast to have any meaning, it should usually be for a year in advance or at the very least a quarter. It does depend on why you are preparing the cash flow forecast, but this white paper is all about future planning and management of cash flow.

It is important to identify cash flow timings on both money flowing in and flowing out of your business; you will need to reflect within the cash flow forecasts when your customers are likely to pay you, post them receiving their invoice. For example, if you offer 30-day payment terms, then this delayed cash flow needs to be reflected accordingly in your cash flow statement. Similarly, with your outgoings, you need to reflect the different payment terms you have with your various suppliers, as some may require immediate payment, whereas others may give you upwards of 30/60 or 90-day payment terms.

Tips for preparing your cash flow forecast

- Be optimistic, but realistic about your sales forecasts. Make sure that you can back up any percentage increase in your sales, as it is important to include an increase, as this will provide an improved target to aim for.
- Make sure that the assumptions behind your cash flow forecast are based upon reality and any improvements to your key performance indications (KPIs), for example sales conversions, have a sound foundation behind the proposed improvement.
- Run a few scenarios, including a worst case scenario and include a break even analysis, so you know what your break even sales are.

- Make sure your key staff are aware of the cash flow forecasts and what their targets are, as there is no point in preparing well planned out cash flow forecasts and then putting the reports in a drawer somewhere, never to be seen again.
- Review your actual cash flow against your cash flow forecast on a regular basis to make sure you are on track with your planned cash flows. Make sure you review your actual bank balance at the end of each month end with what cash balance was forecast.
- Make sure you understand the reason for any variances between actual cash flows and your forecasts and if there is a major fluctuation, you may need to revise your cash flow forecasts, to take account of the difference and/or look at what has change and why and how you can change things to keep your business on track.
- Use your year-end accounts as a starting point for preparing your cash flow forecasts, but make sure you identify the difference between 'Profit and Loss' and 'Cash Flow'. This will help you to set your budgets for overheads and other costs and provide a basis for your sales forecast.
- You can use spread sheet software, like Microsoft Excel to prepare your cash flows, but professional software is a much better tool to use, which not only makes the task quicker, but it also ensures accuracy and the provision of professional reports, which includes the all-important balance sheet report.

Tips for improving business cash flow

The key to any strong business is having a healthy bank balance so you always have the cash to meet your expenditure on a timely basis. Insufficient cash will lead to a cash crisis and will quickly become a stressful situation, if not managed correctly. So in addition to good planning and cash flow management and forecasting, here are a few tips to help you enhance your bank balance:

- Change your customer payment terms and get payment up front. There are certain products or services that we always recognise are cash up front, so why not do the same, as this will improve your cash flow immensely, especially if you have at least 30-day payment terms with the majority of your suppliers.
- Change your payment terms to an upfront deposit or other forms of stage payments, if your service is spread over a longer period from ordering through to final delivery. The more upfront cash you can get the better.
- If you don't change your customer payment terms, you could offer customers an early payment discount to encourage them to pay on a timely basis.
- Making sure you have prepared cash flow forecasts will put you in a better position of knowing what your cash position should be at any point in time. These forecasts will help you to understand when and if you need to take appropriate action within the business to make sure you stay on track. It could be a problem with your collections or perhaps one of the assumptions you made when preparing your plans is not working out as you had intended. By having the forecasts to hand will help you to identify the problem and take quick and decisive

action. You also have the option of revising the cash flow forecasts, if the change is one that is unexpected or cannot be overcome right away.

- Get good payment terms with your suppliers and always run to the term, whether this is 30-day or 60-day terms. This provides interest free credit and is cheaper than borrowing from a bank. However, if your suppliers offer any form of early payment discount, consider taking this, as this can represent a good ROI or return on your cash at bank and with interest rates at record lows, the effective rate of return could be much better than what you'd earn with the cash on deposit. However, make sure you do pay your suppliers on a timely basis, to keep good relations and to avoid delays in your supplies of products.
- Make sure you have a good control over your receivables and this should be set out on an 'Aged' basis – prompt chasing is a must, using letters, phone calls and stronger forms of collection where necessary. Some people will simply not pay until they are chased, so the longer they are left, the longer they will take to pay.
- Give your customers as many options to pay for their products or services, which includes taking debit and credit cards in addition to the usual cash, cheques and direct payments into your bank account. Fees apply to taking credit cards, but this is sometimes a small cost to bear in order to get the cash into your bank account.
- Make sure your invoices are clear and accurate so that your customers can quickly identify what they have been billed for is what they ordered. Make sure the invoice states clearly your payment terms and also provides them with the various methods they can pay. Always include your bank details, as more and more people are using internet banking and will likely pay bills using online banking – make it easy for them to pay.
- Make sure your invoices are sent out on a timely basis, any delays in sending your invoices out will mean a delay in the customer paying you.
- Keep a close eye on spending and cut out any needless expenditure. Make sure you stick to your planned budgets as per the cash flow and profit and loss forecasts you have prepared.

Benefits to a business of having cash flow forecasts

An important anomaly to understand about cash flow and business finance is that the more your business needs a cash injection, the harder it is to get it. Banks tend to run a mile when a business is in difficulty, whereas if things are going well, then they will be 'as happy as Larry' to lend day in and day out. The challenge is to make sure you have a good handle on your cash flow management, so that you are able to recognise at an early stage when you might need finance, and to go about requesting it in the right way and at the right time.

Banks like well managed businesses and if they are shown a good plan with well thought out cash flow forecasts, showing exactly where the finance is needed, they are more likely to lend. The most important message to get across to the bank is that they will get their capital back and they have to believe that this will happen. Which is why it is vital that the assumptions and the numbers used in your cash flow forecasts are realistic and achievable. Banks also like to see your worst case scenarios, and should the worst case scenario still show your business making a profit and still show the bank that the loan will be repaid in full, they will likely lend.

Types of finance

If your business does require finance, but not necessarily because it is in difficulty, but perhaps because of an expansion plan, then bank finance might not necessarily be the right option or the only option available to your business.

So what types of finance are there and how do you choose the right one? To help with the answer to this question you may need to look at how much you are prepared to pay for the finance and how much money you require. The how much finance you require will be born out from your cash flow forecasts, whereas the cost of the finance will depend on the speed in which you need it and the amount of risk involved for the lender or investor.

There are many sources of finance available, which include the following:

- A straight forward bank loan over a set period is the first option, which the bank will usually require some form of security over and in most cases directors guarantees.
- Bank overdrafts used to be a common form of bank lending, however banks are moving away from this form of lending. Where it can be shown that the business genuinely needs to dip in and out of a 'Fund', the bank will consider an overdraft, whereas if it is shown that there is a longer term requirement for working capital where the 'overdrawn' amount is constant, the bank will prefer a conventional loan.
- Invoice finance or factoring, which only applies to businesses which sell to other businesses. Invoice financing or factory can prove to be an expensive source of financing, but can also prove to be a good way of improving your business cash flow and in some cases might be the only available option.
- Hire purchase is another good source of finance and is useful if your plans include the purchase of business assets, as these can be used to secure the hire purchase lending. This type of lending can prove to be relatively cheap and you can get some good deals with this in terms of how much cash you have to put into the deal, as a deposit.
- Lease financing is another way to secure assets for the business, which is similar to hire purchase, except that the asset ownership is different.
- Getting extended credit terms with your suppliers, this is always worth the discussion, as long as they have confidence in your business and understand why you are asking. It will help if there is good competition between your suppliers, as you will then be in a stronger position to play one against the other. But always keep an eye on quality and price too, as you don't want to compromise your business reputation.
- Directors loans where the company directors have spare cash.
- Credit cards are another source of financing that many business owners use. With credit cards offering interest free loans, despite the arrangement fee, this can be a good source of finance for smaller businesses.

- Family and friends are always a possible option, but be careful, make sure you repay these loans, if you don’t want to have a rift in your family.
- If you are open to having outside shareholders and investors in your business you could go down the venture capital route. This can be more epxensive in the long run over bank lending, as you are ‘giving away’ a share in your business together with share of the profits in the form of dividends, depending on the deal you strike. You will also relinquishing a degree of control and most venture capitalists will want to have a say in the business with a position on the board.

Summary

This white paper is about ‘Cash Flow Being King’ and this is essentially about how cash flow is the life blood of any business. Having good cash flow management together with good tools and software, is the key to running a successful business. Having good upfront planning and weekly management of your cash position will make sure you are on top of your cash position and you will be able to identify any problems before they become a major issue for your business. Identifying a cash flow short fall at its earliest stage is crucial for you to act upon the cause or to set about obtaining finance before it becomes too larger a problem, where finance may then no longer be an option. There is always a good saying to keep in mind and that is ‘What you measure you can manage’ – so plan, measure, monitor and manage your cash flow to ensure you always have a good healthy business.

So what should you do now?

Your starting point is to decide on whether you are going to reinvent the wheel and prepare your own cash flow and profit forecast from scratch using Excel Spreadsheets. Or are you going to invest in professional software to do the job for you? Once you have decided upon this question, you’ll then need to set about pulling your information together and drawing on realistic assumptions before you set about entering the data into your cash flow templates. The split of time spent on this exercise should be biased towards data collation and not in preparing the cash flows themselves. With good professional cash flow software, you should be able to have professional looking and accurate reports done within half an hour to an hour or so, once you have collated your data and assumption you will be using.

Resources

Free Trial Version of Cash Forecaster - Download this free version of Cash Forecaster software to trial the great functionality and confirm the software's ease of use and quick to start system. You will quickly see why our No. 1 cash flow software is the best value for your money on the internet, with no compromise on functionality.
http://www.bowraven.com/prodshow/Free_trial_version_download___more_detail/freecffs.html

Basic Version of Cash Forecaster – Provides a low priced option for simple 12-month cash flow forecasts and can also be downloaded.
http://www.bowraven.com/prodshow/Basic_version___12_month_cashflow_forecast_software___more_detail/basic12cffs.html

Standard Version of Cash Forecaster – Download this 3-year forecasting version.
http://www.bowraven.com/prodshow/Standard_version___3_year_cash_flow_forecasts___more_detail/standard3cffs.html

Vision Version of Cash Forecaster – Download this 5-year forecasting version.
http://www.bowraven.com/prodshow/Vision_version___5_year_cash_flow_forcast_software___more_detail/vision5cffs.html

Pro and Pro-Plus Versions of Cash Forecaster – Download these 7-year forecasting versions each with slightly different attributes.
http://www.bowraven.com/prodshow/Pro_version___7_year_cash_flow_forecast_software___more_detail/pro7cffs.html
http://www.bowraven.com/prodshow/ProPlus_version___7_year_cash_flow_forecast_software___more_detail/proplus7cffs.html

Increase Profit Software – Download this software and work through the manual and you may find you don't actually need finance at all. The manual includes real case studies on how this remarkable piece of software will help you realise profits you never knew existed within your business. You will also discover the 7-ways to grow your business – the investment in this piece of software could be the best thing you ever did for your business!
http://www.bowraven.com/catshow/Increase_Profit_Software/increaseprofit.html

This white paper has been written by Russell Bowyer ACA, CTA – A qualified Chartered Accountant with the Institute of Chartered Accountants in England & Wales and a Qualified Tax Adviser with the Chartered Institute of Tax.