How To Control Cash Flow

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Everyday we hear about the problems in the financial arena. First, it was the sub-prime mortgages, then, the staid Wall Street institutions, followed by the banks, the automotive industry and the general economic malaise. Just when we thought it couldn't get any worse we were introduced to Bernard Madoff who single handedly cost people their life savings, wiped out nest eggs that had been accumulated over generations, destroyed charities and generally reeked havoc on an already battered financial community.

It is my hope you were not affected by these financial traumas, but regardless it behooves you to be prudent about the way you manage your financial situation.

According to Michael Gerber, author, The E-Myth: Why Most Small Businesses Don't Survive and What to Do About It, 40 percent of businesses fail in their first year and 80 percent fail within their first five years.

Additionally, statistics from the U.S. Small Business Administration Office of Advocacy in 2008, state there were 627,200 new businesses, 595,600 business closures and 43,546 bankruptcies. Seven out of 10 new employer firms survive at least two years, and about half survive five years.

I've worked with hundreds of small business owners and I know that by adopting a few easy rules you can sleep at night knowing that you have control of your money.

There are a number of reasons businesses fail, but one of the major reasons is due to the lack of cash. Typically a small business owner opens his doors never realizing the importance of planning, never realizing the importance of projecting and forecasting cash flow. There is rarely any thought to how and when money will start coming in, yet, bills have to be paid and unless funds are set aside to keep the business afloat, it will fail.

But this doesn't have to be. There is a relatively simple solution: Control your cash flow, manage it, handle it with care and your business will not only survive, but it will thrive.

This guide will show you a simple way to control your cash flow, keep your business thriving and achieve your desired goals.

JUGGLING MONEY

In today's world, many people are juggling money regardless if income is consistent from a good paying job or a profitable business. There are still debts to pay and when unexpected bills pop up, sometimes it can be difficult to manage. Yet, by managing money and controlling cash flow things will fall into place.

CASH IS KING!

You've all heard the expression **"Cash is king!"**
Cash is king, especially when it comes to controlling your cash flow while trying to build your business.

Take some time and think about the lag time between paying your suppliers and employees and the how long it takes you to collect from your customers/clients. It can be difficult to bridge this financial gap and this time lag can cause you unnecessary stress. But it can be done — Control your cash flow and you'll be able to manage it.

Managing the control of your cash flow simply means postponing your outlay of cash as long as possible and persuading those who owe you money to pay you as quickly as possible.

MEASURING CASH FLOW

The key to understanding how to control cash flow is to measure it. By having a precise cash flow projection you will be aware of any problems before they arise.

It is important to understand that cash flow plans are not a glimpse into the future. There is no crystal ball to give you the answers. There are opinions based on a number of factors: your client/customer's payment history, your accuracy at identifying expenditures and the patience of your vendors. If you can't justify that your receivables will come in regularly, don't assume that they will. Determine whether you can extend your payables. Be sure to include your capital improvements, expenses, and interest on loans, principal payments, and the fluctuations of seasonal sales. Don't throw the dice. It's too risky.

CASH FLOW PROJECTIONS

Projecting cash flow can be one of your most powerful tools in managing your cash. It allows you to see the flow of cash coming in and going out of your business daily and enables you to plan for the excess as well as the shortfall.

To put it simply, cash flow projections are the process of forecasting of your company's income and expenditures weekly or monthly. It's similar to balancing your checkbook and preparing a budget at the same time. However, unlike doing a budget, it only deals with your cash transactions during a specific period of time.

Cash flow projections should be tailored to your business. Identify each month's expected income, using your annual operating budget as the starting point, then select anticipated monthly expenditures, and you will be clear about your cash flow for each month.

In order for your cash flow projections to be effective it is important to update your cash flow projections monthly, if not weekly. You should use actual financial information ie; checks, receipts, bills and actual transactions.

Your findings will tell you what actions need to be taken and which expenses you need to watch to ensure that your cash flow remains positive.

CASH FLOW BUDGET ANALYSIS

A cash flow analysis budget is a way managing the financial health of your company. The goal of this analysis is to be sure there is enough cash to run the company from month to month.

The cash flow analysis budget is a part of your company's financial forecasting plan. It is important to ascertain the amount of cash that will flow into your firm during the month. If you are a startup business, you should include the beginning balance in cash in the amount you want to have available every month. Also track the sales during the first month. The sales include both cash sales and sales to your customers who pay on credit. Here is an example of how to prepare the cash budget;

CASH BUDGET EXAMPLE

3 Components Necessary For Creating A Cash Budget

- Time period
- Desired cash position
- Estimated Sales and Expenses

Small Business Cash Budget Example

For the three months ending March 31, 20XX

	January	February	March
Beginning Cash Balance	$15,000	-$13,500	$20,000
Expected Cash Receipts			
Cash sales	$20,000	$25,000	$30,000
Collection of accounts receivable	$45,000	$55,000	$70,000
Other income	0	0	5,000
Total Cash Available	$80,000	$66,500	$125,000

	January	February	March
Expected Cash Payments:			
Raw Material (Inventory)	$50,000	$11,000	$ 5,000
Payroll	$10,400	$10,400	$10,400
Other Direct Expenses	$2,000	$2,000	$2,000
Advertising	$10,000	$0	$0
Selling Expenses	$6,000	$8,000	$6,000
Admin Expenses	$4,500	$4,500	$4,500
Plant & Equipment	$10,000	$10,000	$10,000
Other Payments	$600	$600	$600
Total Cash Expenses	$93,500	$46,500	$38,500
Ending Cash Balance	**-$13,500***	**-$20,000***	**$86,500**

*The Ending Cash Balance Becomes The Beginning Cash Balance For the Next Period

The next portion of the cash analysis is to determine the amount of cash that will flow out during the month. Keep track of your expenses ie; office supplies, advertising, car expenses, and payroll. There will be quarterly expenses ie; taxes and you might have occasional expenses ie; computers or other capital expenses. You may have expenses that just occur occasionally, like purchases of computer equipment, vehicles, or other larger expenses.

Be sure the cash that flows into your business is more than the cash that flows out. This will ensure that you will have enough cash to operate your business. If you project a shortfall then you must either borrow, invest, reconsider expenditures or increase sales to cover the shortfall. If you borrow to cover the shortfall be sure to include repayment of the debt and interest in future month's projections.

The beginning balance for your second month should be your ending balance for the first month. Each month, as your business grows you might consider adding more items to your cash flow analysis.

You need to decide what the minimum ending cash balance is that you find acceptable for your business and aim toward that figure each month.

PLANNING IS KEY

Lay out a simple grid with columns across for the next twelve months and list down the side your income and expenses. Total these for each month to see your net inflow and outflow.

Spreadsheets lend themselves to cash flow forecasts but you can also do them on paper. If you use a spreadsheet package, do some back-of-the-envelop checks to ensure your formulas are correct. Many banks have suitable ready-made paper forms you can use or templates for spreadsheets. Forecasts rely on your knowing when cash comes in and when it goes out:

CASH IN

Put down your current cash in hand or in the bank. List all the money that you expect to receive this month totaled under headings like cash sales, credit sales, cash injections.

Remember, we are talking about **cash collected not sales on credit.** So include cash in receivables collected from credit sales made in previous months. Exclude orders in hand and invoices waiting to be paid.

Now repeat the process for each month, again working with expected actual cash collection rather than sales. Take your sales projections and allocate how much will be paid at once, and how much in the future.

Don't worry too much about being exact. The further ahead you forecast, the more difficult estimates become. Most businesses just need a fairly accurate two-month figure and a rough twelve-month forecast. Lenders may want to see a two-year summary.

CASH OUT

Now list your outgoings for this month. Some things are predictable: rent, lease payments, wages, drawings (for your personal expenses) and insurance. Also list outstanding invoices due for payment from previous months.

Charges for variables like phone bills and office expenses are slightly harder. If you have no previous figures to go on, make a realistic estimate. List other expenses you will have to pay cash for this month. (Items bought on credit or with a credit card will appear next month.)

Extend these figures for the following months as best you can. Remember taxes that will depend on projected sales.

STOCK UP

Next calculate what you will need to pay for inventory or material, and when, again base it on your sales projections.

START THE SWEEP

Now comes the fun part. Add up the first month's outgoings and subtract them from receipts. This shows your cash surplus (or deficit) for the month. Add this figure to the cash-on-hand to give your expected cash position at the end of the month. Repeat this process for each month. Warning signs are continuing deficits and a negative cash position. If this occurs immediate action must be taken. Otherwise your business may become another negative statistic. See page 18 for suggested remedies.

JUDGE YOUR INCOME

Planning your sales levels requires market research and past experience. Err on the side of caution. Sales will also depend on your marketing efforts, staff levels and production capacity. These all involve cash outlay before any money comes in.

Record any assumptions you make in your forecasting, such as how long you expect customers will take to pay you. If you offer 30 days' credit but they take around 45 days to pay, your figures will be incorrect and you may not have enough cash to keep going until you receive those outstanding payments.

CASH IS NOT PROFIT

If you buy something for $50 and sell it for $60 you make $10 profit. If you pay your supplier in June but do not sell the product until September, and then don't get paid until mid-November, you have a $50 deficit for five and a half months. That $10 profit could have been eaten up in overdraft interest. That's why fast, under-capitalized expansion can be fatal. Many a business fails despite a full order book.

BIG PAYMENTS

Your cash flow forecast is a big help to manage big, one of payments, like your insurance premium or tax bill. These may fall in your low season, when cash is short, so you must put money aside for them.

Remember why you're doing it... A cash flow that is projected well will reduce one of the biggest threats to your business. And most important, it will greatly increase your chances being around this time next year.

MANAGING A CASH FLOW DEFICIT

A cash flow deficit arises when the cash balance is too low to meet the obligations when payments are due. In our example, the organization has a cash flow deficit of $13,500.00 in January and $20,000.00 in February. This doesn't necessarily mean that the organization is running an overall loss. It means that at a specific point in January and February, the organization does not have enough money to pay its expenses.

Since your cash flow projection tells you when you will need additional cash, you are alerting your organization to explore its options to remedy the shortfall. This is the purpose of the cash flow projections — it gives you the time to plan for deficits rather than react at the very last minute, it gives you the time to be proactive. When you do have a cash flow shortage, it is important to remember that there are some expenses you must pay on time. These include, but are not limited to payroll, payroll taxes, insurance and rent.

How do you manage a cash flow shortage? There are numerous ways, but one of the best is to use a line of credit from a bank. The line of credit helps smooth over fluctuations in your cash flow. Aside from the closing costs, when the line of credit is opened, there is no cost or interest assessment to your organization unless you use the line of credit. It can take a few weeks or as much as several months to close a line of credit, therefore, you should apply well before you are in need of it, and preferably when you have a surplus of cash. It is important to establish a relationship with your bank long before your need to borrow.

Additionally, there are other ways to address a cash deficit:

Get a Short Term Loan — There are a number of lenders and banks that provide short-term loans. These institutions can provide "working capital loans" that are designed to help cover your operating expenses. For the most part these loans are for a short term (a maximum of one year) and you are expected to pay back the money once funds are received.

Accelerate Collection of Accounts Receivable — Occasionally, you might be able to speed up the collection of the money that is owed to you. And once more, the cash flow statement can be help in structuring your receivables to avoid the cash flow deficit.

Cut Expenses — There might be expenses in your budget than can be cut or deferred. It is a must that you watch out for line items that continue to exceed your budget.

Delay Your Payment To Vendors — You might want to negotiate with your vendors if you are really tight. Look for bills that are due in 30 days and try to extend the payment to 60 or 90 days. Be honest and explain your situation. Ask for a revised schedule to pay rather than ignore the bills. Do not ignore payroll or payroll taxes. These are a must pay.

MANAGING A CASH FLOW SURPLUS

It is just as important to plan and anticipate how you'll manage your cash flow surplus, just as with a deficit situation. Some of the options are:

Invest In Short Term Instruments — Through low risk, safe investments, you can add interest income to your bottom line.

Invest In Liquid Instruments — You might want to consider investing the cash surplus in a liquid account, such as a money market, if you carry a cash balance in your accounts month to month.

Purchasing — Use the surplus to buy supplies or inventory that you will use over the course of the year at a reduced, volume rate.

COLLECTING FROM SLOW PAYERS

Cash flow becomes more difficult when the economy goes into a slump. At such time, collecting money owed should be at the top of your list. This is a time when credit is hard to come by and many clients/customers take longer to pay bills.

So how do you deal with this? How do you get paid when the economy is in the tank? Do you hire a collection agency or will that alienate clients/customers? Yet, you don't want to look at a pile of unpaid bills.

In looking at options to solve this problem persistency is key. Get credit reports ie; Dun & Bradstreet, on clients/customers and learn their financial status. If credit is poor, cut off their credit line and make them pay cash.

Take control and set terms. Negotiations can work to your favor before the product/service is purchased. You know your budget, and set a timetable for payment.

Negotiations can be amicable giving you more options. Schedule payments 10, 20, 30 or 60 days, getting the invoice in your system. Building relationships and negotiating with the right person works to your favor getting you paid faster.

Be sure your invoices are correct. Don't overlook any forms. Businesses don't need any excuse to delay paying your bill. Be sure that no information is missing on any of your invoices. Does your invoice need a purchase order number? Sometimes omitting this number will delay payment and the bill lingers in accounts payable. Is the invoice formatted correctly? Each company has their own system for accepting an invoice. And if you are a new vendor there might be a new vendor form to fill out.

Know when it's time to tell a client/customer good-bye. May times we think we can't afford to lose a client/customer. Take a good look at your customer/client list and decide if this is someone we want to hold on to or let them go. Consider how long it has taken for them to pay your bill/s and use this as your guideline to continue having them as a client/customer. Ultimately, the economics will decide for you. Consider how much it cost to get them as a client and how much you lose by keeping them on if they are delinquent in paying their bill/s.

You've probably heard, "the check is in the mail." Sometimes it is and sometimes it's not. Don't rely on that. Push for a direct deposit or electronic transfer to your account. Find out about other bank services that can work in your favor, ie; checks can be scanned or faxed allowing money to be deposited in your account that day.

Another delay tactic is companies saying they changed accounting systems. If this is the case tell them you will physically pick up the check stating this is important enough to take time from your day.

Offering a discount can be another option to get paid faster. It's not as if you are rewarding a client/customer, but in certain instances giving a discount on the debt owed assures your getting paid immediately. Make it cash or cashiers check only. And make it no less than a 10% discount. This makes it more worthwhile.

CONCLUSION

Being able to accurately control cash flow provides a solid foundation for a successful business. This guide has explained the necessity of having a handle on cash flow and explained how to do it.

If you find the process confusing or undoable, consult with a professional. There is also software available that can simplify the process.

It's up to you to control your business, not let your business control you. Follow my suggestions and you will run a successful and thriving business for years to come.

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