Controlling your cash flow

Cash is the money kept in the cash register or bank account—the money you use to pay bills, wages, taxes and other expenses. How you manage this cash is critical to the success of your business.

A business needs cash to keep going, just as a car needs petrol. Efficient cash flow management can enable you to fuel the business with sufficient liquidity to keep it running smoothly—so you get the most mileage out of each dollar.

This involves:

- knowing where your cash is coming from
- knowing where your cash is being spent
- ensuring that your cash is properly accounted for and safeguarded
- estimating what your future cash requirements will be
- planning to have your cash ready when you need it.

Profit is not cash

It is important to remember that cash flow is not the same as profit. Cash flow is concerned with matching cash coming in with cash going out. In accounting, profit is income minus expenses. It is very important to master this difference to understand what cash flow is all about.

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Sooner or later most businesses come across the problem of cash, that is, having to find some money quickly. While a business may be profitable, it can nevertheless fail simply because it cannot find the ready cash to pay its bills when they are due. For example, you may be expanding quickly, have hired additional staff, need to pay them but haven't yet received enough cash to pay their wages. Or you find that unless you can pay your supplier's account of $12,000 by the end of the month, they are going to stop supply and bring your production to a halt.

Desperate last minute appeals for cash and credit seldom work—they don’t usually result in a positive response nor do they solve the basic problems which cause cash shortages. Turning up at a bank to seek relief from an unexpected shortage of cash is hardly the way to give the bank confidence in the managerial ability of your business.

Here are some suggestions to help you improve your cash flow.

- Draw up a cash flow forecast and discuss this with your accountant and bank manager to see if a plan can be worked out to improve your cash flow (To help you with this, use the Annual cash flow forecast fact sheet on this website).

- Review all your business expenses and see if there is any possibility of reducing these costs temporarily. For example, look at vehicle use, mobile phone costs, stationery, contractors.

- Check your prices. Make sure that you are charging correctly. If necessary, re-cost so that there is a proper margin put on to the costs of a particular product. Some businesses record ever increasing sales figures and yet their cash situation is critical from month to month. It’s possible there is not enough profit built into the products and the sales are only covering the costs of getting the product out.

- Minimise your stockholding. Carry out an immediate stocktake including raw materials and packaging and identify which stock is readily saleable and which is out of date. The more stock you have sitting around, the more cash is being lost because that stock could have been converted into cash. You will need a certain level of stock to satisfy clients and to also ensure that you generate good sales. However, only hold sufficient stock to keep the business and the clients happy.

- Review your immediate sales program to decide your real sales potential within the next month, three months or six months.

- Get cash first and give credit last. Don't extend credit to anyone unless necessary. A cash business is ideal, even if you have to give a discount to get that money into the till.

- Get your invoices out quickly so that your debtors can pay them by the due date. Make sure this side of the business is efficient. If you have made sales and they need to be charged or invoiced out, then this area of the business is obviously very important. These are minor matters, but it is the small things in business that can cause the biggest problems.

- Prepare a list of your debtors (that is, people who owe you money) and carry out urgent action to collect. If payment is still not forthcoming, then follow this up with a demand in writing. If payment is still not made, consider the services of debt collectors if debtors do not respond to your reminders. The fact that this could affect their credit rating usually moves debtors to pay to maintain their good business name. It is better to lose the business of a bad debtor than to continually spend time and resources chasing money owed to you.

- Prepare a list of your creditors (that is, firms to whom you owe money) and make arrangements (if possible) to get extended credit on money you owe. Instead of getting 30 day terms, see if that can be extended to 60 or 90 days. Remember, this is interest free money and having the extra time gives you the ability to collect all your money before you have to pay your bills.

- Investigate leasing assets instead of buying them. Instead of paying cash for vehicles or equipment, look at leasing them. Even though leasing may cost you a little bit in interest, it can improve your cash flow and allow you to put that cash to better use.

- List any assets such as plant and equipment that are not in use and that can perhaps be sold for cash.

- Check your present overdraft accommodation. If you are over the limit, talk to your bank to see what can be done about it.

- Do not over commit as far as loans are concerned, because their servicing can greatly affect your cash situation.

- Make sure you plan well ahead of any capital expenditure because this outlay will not bring in a quick cash return.

- Always carry a cash reserve under which you will not make any more payments until the liquidity situation is improved. This applies mainly to your working capital requirements.