

key business drivers

3

Cash flow

Cash is something we'd all like more of and if you're running a business, chances are it's something that's often on your mind. Good cash flow not only helps your business to run smoothly day-to-day, but it can also help you grow your business and invest for the future.

What is cash flow?

It's important to understand that cash is not the same as profit. Your profit is the difference between your income and expenses; but cash flow is the difference between the money coming in, versus the money going out. Sources of cash flow include sales and fees received, as well as contributions from owners and loans from banks. There are two main forms of cash:

- **Short term** cash or working capital, is the money you need to cover the period between when you start doing the work and when you get paid for it.
- **Long term** cash is the money that you need to:
 - Setup or buy a business
 - Fund medium to long-term growth
 - Fund asset or equipment purchases
 - Fund 'core debt' (the overdraft that doesn't go positive)

Why focus on cash flow?

Solid cash flow management is at the heart of good business strategy. It's a critical key performance indicator (KPI) of business success, so it pays to spend some time checking in with your approach to make sure it's on the money. You need cash flow to grow your business because as your turnover increases, debtors and expenses will increase and you'll need more working capital.

In most businesses, money gets spent on business expenses as well as buying equipment, paying tax, paying off loans and profit distributions to owners. This means a business can still fail, even if it's profitable, due to difficulty in managing cash. A business can also have cash flow problems because of timing. For example, you may need to pay your rent and wages, and buy stock, before your customers have paid you. So having a reserve is important. Also have a good understanding of the timing of your cash flows so you are aware of upcoming shortfalls in cash.

Proactive management of your cash makes your business more stable and less risky. What's more, preventing cash flow problems in the first place is an easy way to reduce risk and hassle in your business down the track.

Tips to structure your finance

- Make sure that you get the right finance for the right purpose (eg short term finance versus long term finance).
- Match the finance term to asset life eg if you keep cars for only three years then only finance it for three years.
- Have finance ready before you need it.
- Use secured finance to get lower interest rates.
- Get the right mix of secured and unsecured finance (don't use up your bricks and mortar security securing car or equipment loans if you're going to need it to secure a working capital loan).

Tips to manage cash flow

There are many ways to ensure that you stay on top of your cash flow requirements:

- Get your pricing strategy right
- Be aware of seasonal trends and unusual events, plan ahead and manage your cash flow accordingly
- Monitor stock levels and don't have more stock on hand than necessary
- Watch discretionary expenditure and manage appropriately
- Prepare and monitor your financial information on a monthly basis. Analyse the information and quickly make any necessary changes – don't try to ride out any low periods.
- Monitor leading indicators on:
 - Forward bookings
 - The number of referrals received
 - The number of telephone calls or enquiries received
 - Conversion rates – the percentage of quotes issued vs accepted, the number of customers in the door (how many leave empty handed – why? Wrong product, price or bad service?)
- Use active cash management:
 - Deposit cash/cheques as soon as they come in
 - Don't keep too much money in your cheque account – transfer it to an interest bearing account
 - Don't pay creditors too early or too late

Tips for managing debtors

Before the job

- Take the time to credit check new customers. It can save you a lot of grief later.
- Have good engagement processes. Provide accurate quotes that detail your terms, including the due dates for payments.
- Maintain a good spread of customers so that if one defaults it doesn't hurt too much.
- Get deposits or payments upfront, especially for projects that have high up front expenses.

During the Job

- Manage job turnaround times – the faster you do the job the faster they'll pay!
- For service businesses that carry work in progress, issue progress invoices.

After the job

- Don't wait to send an invoice. Instead of billing at the end of the month, bill as soon as the work or project is completed, or when the stock leaves your business.

To get your cash flow under control

- Cash isn't the same as profit
- Keep up-to-date records of how much cash and profit your business is making
- Manage debtors and creditors efficiently
- Understand your short-term versus long-term cash requirements, and
- Use finance correctly where necessary.

- Format your invoices properly. Have a specific due date for payment (not just 'in 14 days').
- Make it easy to get paid 24/7. Offer BPAY, EFTPOS, credit card and website facilities.
- Offer discounts to motivate customers to pay earlier and don't wait for people to get around to paying you – call them as soon as the invoice is due.
- Deposit the cash or cheques as soon as they arrive – don't bank just once a week.
- Settle customer disputes quickly. Unhappy customers generally won't pay until they're satisfied.
- Don't send aged statements as reminders, send letters of concern instead.

Tips for managing creditors

- Negotiate extended payment terms, ask for bulk and volume discounts and rebates, discounts for early payment and supplier support for advertising and marketing
- Don't pay them too early or too late!
- Nurture strategic suppliers
- Seek competition for commodity supplies
- Review stock management strategies
 - On the shelf or Just-In-Time?
 - Consider re-order periods
 - Be aware of minimum re-order quantities
 - Be aware of shipping/freight efficiencies.

Want help with your cash flow?

Getting your cash flow under control will make your business run better, unlock your growth potential and will alleviate stress and hassle. No matter where your business is at, a trusted DFK adviser can help you get the right foundations in place. If you're ready to make changes or simply want to discuss your options, call us on

1300 DFK ANZ

Disclaimer

The fact sheet has been prepared by DFK Australia New Zealand Limited. Any advice contained in this document is of a general nature only and does not take into account your personal objectives, situations or needs. Prior to acting on any information in this document, you need to take into account your own financial circumstances and we also recommend seeking independent financial advice.