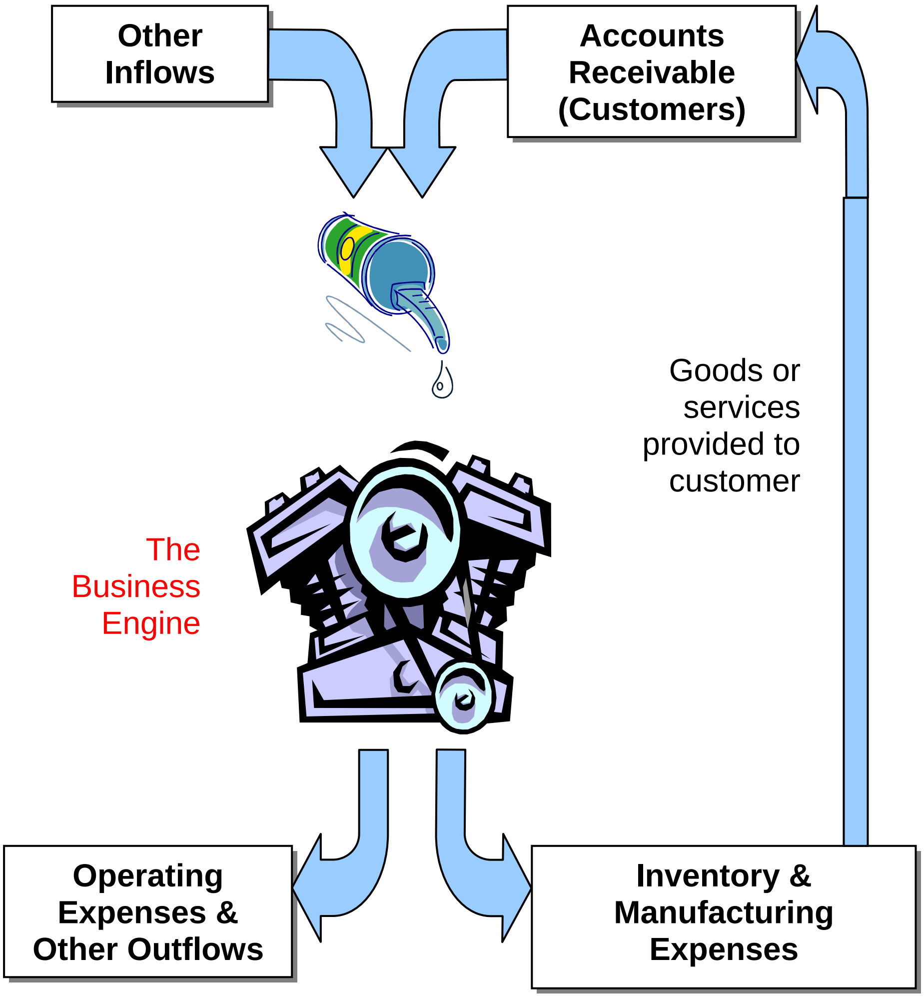
ALL YOU NEED TO KNOW ABOUT CASHFLOW……

What is Cashflow?

In it's simplest form, cashflow is the movement of money in and out of your business. This is often referred to as the 'Cashflow Cycle' as shown in the diagram below.



Cash in a business is just as important as oil in an engine. No matter how powerful and big the engine may be, without enough oil the engine will seize up. Similarly, no matter how powerful or big your business may be, without enough cash it will simply cease to exist. Cash is King!

Cash Inflows:
Inflows are most likely to occur from the sale of good or services to your customers. The collection of the sale will represent a cash inflow.

Other inflows that might occur include proceeds from a bank loan and injection of funds by the owners.

Cash Outflows:
Outflows are most likely to occur from the purchase of goods & services. The payment for the purchase will represent a cash outflow.

Other outflows that might occur include repayment of a bank loan, owner’s drawings, purchase of machinery and paying income tax.

It is important not to confuse profit with cashflow.

What is the difference between Profit & Cash?

Many people often confuse profit with cashflow. The question is often asked “Why don’t I have any money in the bank, yet I’m making all this profit?" There are many other factors that contribute towards your cashflow that can be best explained in the following example:

	Profit			**Cash**
Income	$100,000	Cash collected →		$80,000
Less:				
Expenses	$50,000	Cash paid →		$50,000
Profit	**$50,000**			$30,000
Add Other Inflows:				
Loan from Directors				$10,000
				$40,000
Less Other Outflow:				
Principal Loan Repayment			$20,000	
Machinery			$10,000	
Income Tax			$25,000	
				$55,000
Cash Deficiency				**($15,000)**

In the example above, the business has generated a profit of $50,000 for the month, however their bank account had decreased by $15,000. This is due to the following:

- The business invoiced $100,000 for the month, however only collected $80,000.
- There were ‘other outflows’ incurred that effect cashflow but have no impact on profitability. The principal loan repayment, income tax & machinery purchase were all funded from the bank account.

Why is Cashflow Important?

A healthy cashflow is an essential part of any successful business. No matter how sophisticated your processes, or how wonderful your products may be, if your business runs out of cash, it will cease to exist. Some business people claim that a healthy cashflow is even more important that your business’s ability to deliver it’s goods and services! That may be placing a bit too much importance on your cash flow, but consider this – if you fail to satisfy a customer and lose that customer’s business, you can always work harder to please the next customer. But if you fail to have enough cash to pay your suppliers or employees, you’re out of business! No doubt about it, proper management of your cashflow is a very important step to making your business successful.

How to improve your Cashflow?

There are numerous ways to increase profitability, which may also lead to an increase in cashflow. However, if we are only concerned with directly improving cashflow, it can only be achieved by one of two ways:

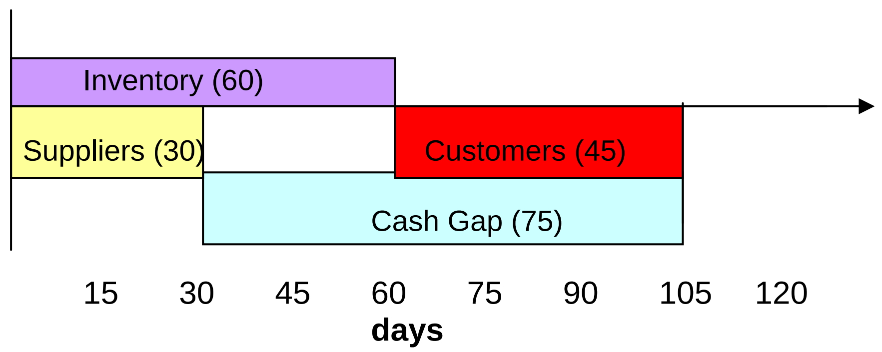
1. Accelerate your cash inflows.
2. Delay your cash outflows.

Delaying cashflow does not mean paying your suppliers outside their credit terms but rather delaying the payment until it is due or identify other opportunities where payments can be deferred. For example, when choosing a supplier, consider the credit terms they offer.

Improving your cashflow can be achieved my reducing the cash gap as explained below.

Cash Gap

The cash gap is the difference between when you collect your sales and when you pay your suppliers. This is illustrated below:



Note that if you are in the service industry, suppliers become wages and inventory becomes work in progress.

Based on the example above, suppliers are paid 30 days after the goods are acquired, the customer is invoiced in 60 days and they then pay their account in 45 days. This would represent a cash gap of 75 days, being the difference between when the customer pays and when you pay the supplier.

To reduce your cash gap and thus improve your cashflow, you can consider the following:

1. Defer paying suppliers until the due date or re-negotiate supplier terms.
2. Reduce the time the goods are tied up in inventory.
3. Accelerate your customer collections.

A cashflow budget can also predict your business's cashflow gaps, so that steps can be undertaken to ensure the gaps are closed, or at least narrowed.

How important is a cashflow forecast?

For a business to be successful and able to meet its financial obligations, a positive cashflow (that is more cash coming in than going out) is vital. This doesn't happen by accident, it takes careful planning. Businesses that do this successfully have a cashflow forecast which they can manage monthly (at least) so that they can plan for any cash shortages and put the necessary measures in place to guide the business through those times when cashflow is tight.

Managing your cashflow means measuring it. Once you have the forecast in place, you should compare your actual results to budget to ensure targets are being met. This will allow you to identify problems sooner than later to assist with pro-active decision-making.

Jack Welch, former CEO of General Electric said, “The three most important things to measure in a business are customer satisfaction, employee satisfaction and cashflow”. It’s interesting to note that the only financial measure mentioned is cashflow.

Remember, you can only manage what you measure. So implement a cashflow forecast today and take control because maintaining positive cashflow is essential to the ongoing health of a business.

CashWhiz will help you prepare a cashflow forecast for your business which will ultimately lead to better management, higher profits and greater control!