Foundations of Cash Flow

Whatever your business may be, a healthy cash flow is critical so you can meet the ongoing financial commitments required to keep the business operational.

Our webinar looks at three key cash flow areas:

1. What is cash flow?
2. Where does cash hide in the business?
3. How can you improve cash flow?

What is cash flow?

Cash flows are a result of how much cash revenue you earn through sales minus how much cash you spend to keep the business operational.

In order to sustain a business it's important to measure how much cash you have available at any given time i.e. you need to know your 'cash position'.

Simply put, your cash position = incoming cash – outgoing cash

There are three states your cash position can be in:

- **Positive cash position**: this means you have spent less money than you have earned. A positive cash flow is the ideal position to be within your business as it opens up possibilities for you. It gives you the capacity to grow, improve the quality of your product or upgrade equipment or hire more staff.
- **Neutral cash position**: this means you have spent exactly what you have earned.
- **Negative cash position**: this means you have spent more money than you have earned. Here you will need to find cash to cover the shortfall in funds. Funding options include using your own money, looking for investors or borrowing.

One way of better understanding when you may experience a cash shortage or surplus is via a cash flow budget.

A cash flow budget is a financial tool that will help predict the availability of cash in a business at any given time.

Where does cash hide in the business?

**Working Capital Cycle**

Cash shortages are often caused when cash gets caught up or ‘hides’ in our business. Understanding how and where that might happen will help to keep the cash flowing.

The Working Capital Cycle is one tool that illustrates how cash flows through a business and helps to identify potential blockages that will prevent healthy cash flow.
How can you improve cash flow?

There are three main areas to consider when looking at ways to improve cash flow:

1. Stock / Inventory
2. Work in Progress (WIP)
3. Debtors

1: Stock/Inventory
Cash often gets caught up in stock. It's important to know how much stock you actually need to satisfy the demands of your customers, plus hold a little in reserve. Anything beyond this is called excess stock and this is what can potentially slow down your cash flow.

2: Work in Progress (WIP)
Work in Progress is another place where cash can get tied up. As you win jobs and start work on them, this is the inflow of WIP whereas completion of these jobs is the outflow of WIP. Whilst the work is happening cash gets tied up in paying for the time, skills and resources needed to do these jobs. This cash is often not recouped until the job is completed and invoiced.

3: Debtors
Just like stock, there will often be a natural level of debtors that is outstanding. If you are issuing invoices with a 30 day collection it’s quite common that not all of them will be paid straight away. The priority for the business when it comes to debtors is looking at how to minimise the level of debtors to free up the cash within the business.

Tips to improve your cash flow

Here are ten tips to help improve the cash flow of your business:

1. Have a good stock management system. Keep records accurate and up to date.
2. Develop good buying practices to maintain the right stock levels at the right time and right price.
3. Review stock handling procedures to reduce damage or wastage.
4. Establish a deposit and progress payment policy for work in progress.
5. Understand which products/services are more profitable. Promote them over other products/services.
6. Give employees the training and support they need to complete deliverables on time.
7. Make issuing invoices a high priority.
8. Ensure due dates and terms of trade are clear on all outgoing invoices.
9. Develop and follow a thorough procedure for payment reminders and following up overdue accounts.
10. Don’t jeopardise your business relationships. Give debtors a chance to explain as there may be a good reason for delays in payment.

Any information provided is of a general nature. Before making any decisions please ensure you seek appropriate professional advice to ensure it is appropriate to you.