Cash Flow is the Life Blood of Every Business – Without it you are Dead

Cash Flow

The biggest challenge a business can have, and the main cause of a business interruption or failure, is a lack of cash for one reason or another. Accordingly, effectively managing cash is critical to any business.

Successful cash flow management does not occur by luck. It is the result of understanding where cash comes from that flows into your business and where it goes when it flows out of your business.

Executive Summary

Cash flow is the life blood of every business – without it you are dead!

As Richard Branson said, "Never take your eyes off the cash flow as it is the lifeblood of every business".

The biggest challenge a business can have, and the main cause of a business interruption or failure, is a lack of cash for one reason or another. Accordingly, effectively managing cash is critical to any business. If you don't have any money you can't pay your employees, your suppliers, your loans, or buy needed equipment. More importantly you can't pay yourself!

Your business needs well-defined and effectively managed strategies to ensure your business does not run out of cash.

If your business has cash flow problems, until the systemic underlying problem is identified and fixed, the problem will persist and will cause insurmountable stress for you and your employees.

Your business needs well defined effectively managed cash flow strategies

This is due to the threat of a business interruption and the uncertainty related to the business' future. More importantly, this uncertainty will usually result in your best employees leaving. Afterall, if they are your best employees, they are the most employable elsewhere, and a lack of cash will drive them to look for alternative employment.

Accordingly, you need effective cash flow management strategies and processes to ensure you are generating positive cash flow, day after day, month after month, year after year to ensure your business' success.

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In This Issue

- **What are the main causes of cash flow issues?**
- **How a part-time CFO from Janmar Consultants can help you correct cash flow issues**
- **Do you need to do cash flow forecasts?**

Introduction

We all manage our personal finances. We all manage our households. Personally, we know our household cannot spend more than we make or bring home on a long-term basis.

A business is no different. It can't spend more than it makes or brings home. This a critical theme that time and time again people involved in restructuring see. Employees do not seem to understand this when they are involved in a business. For one reason or another, employees think businesses run differently. As the owner of a business the sooner you get every employee to understand that cash is king and we need to bring in more than we spend, the sooner you will ensure the successful future of your business.

Successful cash flow management does not occur by luck. It is the result of understanding where cash comes from that flows into your business and where it goes when it flows out of your business. It also involves understanding what you can do to influence or control cash inflows and outflows.

It is also not a one-time short-term fix to a problem. It must be ingrained into the very being of your business and all employees who work for you.

Successful cash flow management will allow you to make proper business decisions based on what is the right decision for the business, not based on having to make a decision because you either urgently need cash or don't have the cash to pay for something you should.

Successful cash flow management makes it easier for you and your team to plan and make the right decisions.

An effectively managed cash flow uses a rolling 3-month forecast, broken down weekly, which gives you and your team a heads up and prediction of when a shortfall or crisis could occur. This will then allow steps to be taken to avoid this crisis. This also allows you to take steps within a week to shift things day-to-day where needed. Annual budgets and forecasts should also have monthly cash flows produced with them to make sure cash is effectively managed to match outflows with inflows.

The main goal is operational cash flow on an annual basis should always be positive and then, where possible, months and weeks should be positive. Successfully run businesses, as a rule of thumb, collect their money from their customers before they pay their suppliers.

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Main Causes of Cash Flow Issues

If you have cash flow problems, they will generally be the result of one, or more of these items:

You're Paying Your Suppliers Too Quickly

Earlier in this article we mentioned that you need to match your suppliers' payments to your customers' payments to ensure you are not paying your suppliers before you get the cash from your customers. If your customers pay you in 45 days, then you want to pay your suppliers in 45 days or more. This is not always easy, but if you can do this successfully it will save a lot of headaches related to fluctuations in cash flow. You also need to be conscious of what your suppliers' tolerances are to stretching payments to them. You want to ensure they do not increase your prices due to, in their minds, unacceptably long payment terms. Additionally, suppliers are your cheapest form of financing as generally speaking you do not pay interest to suppliers, unlike your bank/lender.

Customers Pay You Too Slowly

The reality is whether we like it or not, no matter what credit terms we put on our invoices we are never paid in accordance with those terms.

If we say 30-day terms the payment usually comes in 45-60 days; if we say it is 90 days, the payment comes in 120 days and so on. It is nothing to get mad about, that's just the way business works. All you can do is set your credit terms, and then add a buffer to ensure as much as possible, that you are paid before you need to pay your suppliers.

At the same time, you need to walk the fine line between enforcing payment terms and placing customers on hold due to slow payment and achieving your sales plan. However, at the same time no one needs a customer that never pays them.

Selling Prices Are Too Low or Sales Are Too Low

As a strategy to win customers, some businesses will set prices low. However, two risks result from this – if input costs go up profit margins will get smaller and if they try to raise prices customers may stop buying.

If sales are too low, one of the worst things we can do is fool ourselves into believing sales will increase without any solid rationale. If this is the case, we need to "right-size" the business so that based on a realistic sales outlook the business will make money. This is never easy as it may involve taking a hard look at all expenses.

You Are Holding Too Much Inventory

Many businesses have made the mistake of holding too much inventory. You need to critically evaluate how much inventory is needed to effectively run your business and stick to this.

If sales are too low, one of the worst things we can do is fool ourselves into believing sales will increase without any solid rationale.

How often should your inventory be turning – once every 2 weeks? Once a month? You also need to protect yourself against buying mistakes as best you can. Buying 10 times as much inventory as you need because the per unit cost drops is not necessarily the right decision depending on how long it will be held. You need to ensure appropriate approval procedures are in place to make sure your buyers don't put your business at risk. You also need to be realistic about what your inventory is worth. If a buying mistake is made, if you have too much inventory on hand, if you have old inventory on hand – be realistic about what its value is. If it is obsolete get as much money as you can for it as soon as possible.

You also need a methodology for calculating how much of each inventory item you need to have on hand, how often each item turns and then set minimum order quantities based on this. Excess inventory has hidden costs that a lot of business owners don't realize including rent to store it, bank interest charges since the money has already been spent to acquire it, people costs to move it, count it, etc.

Fixed Costs Are Too High

As previously mentioned, for your business to be successful you need to bring in more money then you spend.

You need to make sure your business is the right size for your level of sales. Make sure you have the right size building for your business, the right number of people and the right amount of equipment. If your fixed costs are too high be proactive to address and decrease these costs.

You Don't Invoice Customers in a Timely Manner and/or Don't Call For Payment

Invoices should be generated and sent out daily.

Afterall if you don't tell a customer how much they owe you; how can they pay you? Waiting to only invoice customers only once a week is never a good idea. If you follow this cycle, you are giving your customers one free week of credit terms. For most of the items you are shipping out, if it is a manufactured good, you have likely already paid for most of the inputs - labour and material to name two.

You also need to follow up with customers to determine if they are happy with the goods or services they receive. By doing this when it comes to collection they can't argue since you have already determined they are happy. Also, don't be shy about calling for payment when payment is due.

Generally, a salesperson is almost always the main point of contact with the customer. They should be more than happy to ask their customer for payment. Your business doesn't need a salesperson that isn't interested in collections…after all they probably had no issue taking their commission related to the sale.

If your fixed costs are too high be proactive to address and decrease these costs.

Customers Payment Terms Are Too Generous and/or You Provide Customers Too High of Rebates

Typical payment terms are net 15 or 30 days. If your terms are too lax (60 or 90 days) you may need to continually borrow money to make up for the difference between this and when you need to pay your suppliers.

Additionally, be careful of customer rebates. In some situations when rebates are based on volume of purchases you can find yourself in a situation where when rebates are stacked up and you end up losing money on your sales. Be careful and make sure you are doing full gross profit analysis for all customers, including rebates and all other costs, to make sure they are all profitable…after all not all customers are good customers.

Too Many Bad Debts

Writing off a bad debt from a major customer could be the death blow to your business.

The key is, as much as possible, have a diversified customer base so any one customer cannot take your business down. Bad debts will occur, it's part of business and any bad debt hurts, the key is to minimize its impact as much as possible.

How a Part-time CFO From Janmar Consultants Can Correct Cash Flow Issues

A Part-time CFO from Janmar Consultants can provide you with a seasoned professional that has worked at multiple companies to resolve cash flow issues.

This seasoned professional will provide you with the experience and expertise to help resolve these cash flow issues that you do not have internally, at significantly less than a full-time CFO.

Your part-time CFO will identify and asses:

Immediate Risks to Your Business

Your part-time CFO will alert you to the issues that could stop your business dead in its tracks. These can include:

- Your lender pulling your bank loan
- Payroll that can't be funded
- Government payments not being made that you as a director are responsible for
- Important supplies not being delivered

Your Part-time CFO will identify and help solve:

- **Short-term cash flow issues**
- **Mid-term cash flow issues**
- **Long-term cash flow issues**

Other Imminent Risks to Your Business

Your part-time CFO will look at, assess and provide solutions to address mid-term cash flow issues to your business, including:

- Identifying customers that owe you money that is due. If needed will a discount get them to pay you now? Would adding early payment discount terms, like 2/10, net 30 get you paid quicker?
- Is factoring receivables a solution? This will get you as much as 85% of the face value of your receivables now, with the remaining 15%, less the fee the factoring company takes, paid when the customer pays. By using a blocked bank account this solution can be invisible to your customers.
- Develop and train employees to use management reports and procedures to increase cash inflows and decrease cash outflows. This can include:

    - Regular review of aged detailed accounts receivable listings to determine late paying customers that need to be called
    - Regular interaction with your customers to ensure they are satisfied with your product or service
    - Review of expected cash disbursements prior to the cheques being sent out to ensure there are no issues with any of the invoices. Also, if you have a temporary cash flow hiccup, pay suppliers for some of the invoices they are due, but not all of them to keep product flowing and save immediate cash now. It is not advisable to use this as a permanent solution only a temporary one
- Consulting with your bank to provide a temporary bulge facility to address a temporary cash flow issue.
- Does your short and long-term financing mix need to be changed? This may be a result of paying for long term assets with short term cash – never a good situation. Ideally you want to pay for long-term assets with long-term financing and support short-term assets with short-term financing/working capital loans.
- Are you paying suppliers too quickly and accordingly, need to ask them for more favourable payment terms? Your ability to get more favourable credit terms is quite often related to how important you are to your suppliers.
- Are there government programs, grants or loans that can assist your business? For example, does the Economic Development Corporation ("EDC") or Business Development Bank ("BDC") or other government organizations have programs your business can benefit from?
- What exactly is the underlying problem and what needs to be done to ensure, as much as possible, this cash flow problem does not recur?

Long-Term Permanent Solutions to Stop Future Cash Flow Issues

Your CFO will investigate and assess all cash in-flows, or lack thereof, and cash out-flows to develop permanent solutions to avoid future cash flow issues.

This can include, but are not limited to:

- What are your breakeven sales and are you operating above this breakeven sales levels?
- Can selling prices be increased to increase profits without losing sales?
- Are there any products or services that are unprofitable and can be discontinued?
- Any additional products or services that can be sold that are complimentary to your current product or service offerings? For example, extended warranties.
- Will customers commit to monthly or annual volumes which provides better visibility and certainty for future sales?
- Can you negotiate better prices with your suppliers? This may be

able to be done by committing to monthly or annual volumes.

- How much money do you as the owner of the business need? Can you draw less to leave more cash in the business for operations?
- Can the lead-time from when an order is received to when it is shipped be decreased? Also, can the time from when the invoice is generated to when payment is received be decreased?
- Does the company need to be refinanced to balance the mix between short-term and long-term debt?
- Are there any costs that can be cut or reduced? Can jobs be combined? Can insurance premiums be decreased by increasing deductible amounts? Can excess warehouse or office space be sublet? Can bonus payouts be delayed?
- Are there any capital projects that can be delayed, cancelled or put on hold?
- Is there any excess equipment that can be sold for cash?
- Rather than purchasing any new equipment or assets, can they be leased to minimize the immediate cash out-flows. This should be done for any leases that have an interest rate lower than what your bank charges you.
- Any old, discontinued or excess inventory that can be translated into cash?

Inevitably, every business at one time or another is going to experience a cash flow issue. The key when this happens is not to panic and to quickly and calmly come up with a game plan and execute it. This calm and calculated approach will result in employees, suppliers, banks and all other stakeholders having confidence in you and your team's ability to address the issue.

Every business at one time or another is going to experience a cash flow issue. The key when this happens is not to panic and to quickly and calmly come up with a game plan and execute it.

Do you Need to do Cash Flow Forecasts?

We cannot stress enough the importance of using cash flow forecasting in a business. It should be broken down into a rolling 3 month forecast by week and then annual budgets should have monthly cash flows included with them.

This tool, when used properly, will give you insight into upcoming cash flow issues long before they occur, so you and your team can take appropriate actions to eliminate or minimize the impact.

More importantly, it will eliminate the stress that comes with an unexpected cash crunch, as it won't be unexpected and ideally will be avoided.

Your part-time CFO from Janmar Consultants will assist and train you and your team on preparing and using these cash flow forecasts. By comparing actual cash flows with forecast expectations and understanding why variances occur will allow you and your team to become more and more accurate over time, and this will put you and your business on a sound financial footing – a goal well worth working towards.

Every business needs cash to survive. The sooner you as an owner can ensure you and your team have a handle on what cash is coming in and what cash is going out, the sooner you will ensure the stability of your business. Running out of cash in a business is never good, so having the insight to know when an issue or issues will occur and being able to take preventative means to avoid it or them will result in success.

Janmar Consultants Inc. have the seasoned experts that can provide your company with the processes and procedures to get a grip on and keep a grip on cash flow forecasting and positive cash flow execution.

Call us today to book your free one-hour consultation to ensure your business is on the right track.

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