

Cashflow management

Any business owner knows that 'cash is king'. While profit, turnover and market share are all indicators of success, if there is no cash in the bank to meet monthly commitments including supplier invoices, wages and loan payments then any business will fail.

In implementing good cashflow management techniques, the following summary describes those areas essential to success.

1. Cash-flow cycle

- 1.1. This acknowledges that resources are utilised to produce goods and services. These are then sold to customers. In turn customers will pay and the business is able to collect and deposit the funds and so the cycle repeats. However it is vitally important to manage and control these cash inflows and outflows. It is the timing of this flow of money that is vital to the success, or otherwise, of the business.

2. Accelerating cash inflows

- 2.1. The quicker that cash is collected, the faster it can be spent to generate further profit. Accelerating inflows involves streamlining all the elements of the cash conversion period, which include:
 - 2.1.1. The customer's decision to buy
 - 2.1.2. The ordering procedure
 - 2.1.3. Credit decisions
 - 2.1.4. Fulfilment, shipping and handling
 - 2.1.5. Invoicing the customer
 - 2.1.6. The collection period
 - 2.1.7. Payment and deposit of funds

3. Cash-flow budget

- 3.1. The cash-flow budget projects your business cash inflows and outflows over a certain period of time. For example on a month-to-month, weekly or daily basis.
- 3.2. The cash-flow budget can help identify cash-flow gaps in the business. The gaps are when cash outflows exceed cash inflows. This will allow you to take steps to ensure that the gaps are narrowed to avoid expensive, uncontrolled overdrafts. These steps might include lowering your investment in accounts receivable or stocks, increasing or bringing forward receipts, or looking to outside sources of cash.
- 3.3. Most lenders providing loans will require the business to create a long-term cash-flow budget as part of the application process. However for business management needs, a six-month cash-flow budget is probably about right. It predicts future events early enough to take some corrective action whilst minimising the amount of uncertainty involved in the budget preparation.
- 3.4. Preparing a cash-flow budget involves:

*Gary Beesley is CIMA
practising Certificate holder*



- 3.4.1. preparing a sales forecast
- 3.4.2. projecting anticipated cash inflows
- 3.4.3. projecting anticipated cash outflows
- 3.4.4. putting the projections together for the cash-flow forecast
- 3.4.5. identifying interest earning opportunities.
- 3.4.6. identifying deficits and the need to accelerate cash flows or borrow short-term money
- 3.4.7. identifying longer-term surpluses to fund expansion and development
- 3.4.8. identifying longer-term needs for funds from external sources

4. Cash-flow surpluses and shortages

4.1. Surpluses

4.1.1. As the business creates a surplus decisions need to be taken.

- 4.1.1.1. It can be placed on deposit with a financial institution to earn interest.
- 4.1.1.2. It can be used to fund capital investment for development and expansion in line with longer-term plans.
- 4.1.1.3. If the funds are surplus to current and future requirements they can be paid to stakeholders.
- 4.1.1.4. Payments to creditors can be advanced to enhance credit credentials for the future.
- 4.1.1.5. Debt can be settled to improve your balance sheet gearing ratio and reduce repayments in the future.

4.2. Shortages

4.2.1. If there is a requirement for additional funds, either to meet short-term shortages or for longer-term development, there are several sources of funds to consider. These are outlined in brief below:

- 4.2.1.1. Overdraft
- 4.2.1.2. Short-term borrowing facilities
- 4.2.1.3. Revolving credit facilities
- 4.2.1.4. Fixed-term finance
- 4.2.1.5. Private share placings or public offerings.
- 4.2.1.6. Factoring and invoice discounting.

5. Using company accounts

- 5.1. There is a wealth of information to be obtained from company accounts, which are held in the public domain.
- 5.2. Much of the information is stated in the notes to the accounts or can be obtained from the written reports from the chief executive and finance director. More information can be obtained from analysing the figures in the financial reports. The standard way of analysing accounts is to calculate 'ratios'. Ratios give you a set of figures to match against industry and company standards. These ratios include; earnings per share, return on capital employed, price/earnings ratio, current ratio, acid test and gearing.

6. Insolvency by overtrading

- 6.1. In situations where cash flow is poorly managed, a company's success can lead to its own downfall, referred to as 'overtrading'. This situation arises when 'cash inflows' lag behind 'cash outflows' causing a state of 'cash shortfall'. This 'cash shortfall' is proportional to trading volume. In a normal steady trading situation the cash-flow gap can be managed through retained profits for example. However if trading volumes suddenly rise, in the long term this should translate into profit. In the short term increased trading volume means increased 'cash shortfall'. Unless this shortfall has been anticipated and plans put in place to address the shortfall, there will be bills to pay where the cash is not available.