CASH FLOW STRATEGIES

Mark A Coudray

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MARK A COUDRAY

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CASH FLOW STRATEGIES

Mark A Coudray

A complete understanding of the role of cash flow is essential to the health of any business. Cash is the lifeblood of business. Without it, you're simply done. It is extremely common to see businesses run out of cash and close their doors suddenly, even though they have tons of work and are working overtime.

As we shall soon see, cash flow and profitability are related, but are two completely different things. You can be profitable but broke as well as having cash in the bank and be highly unprofitable. This ebook has been designed to give a foundational understanding on how to improve the cash flow and cash management of your business.

Monitoring your cash flow regularly is a critical aspect of managing your small business finances. Simply put, cash flow refers to the amount of cash coming into and going out of your business.

By keeping track of your cash inflows and outflows on a regular basis, you can identify potential cash flow problems and take corrective action in a timely manner.

The most common approach is simply looking at the daily cash balance in your bank account. While common, it does not work over the long run and is inefficient and inaccurate.

This is probably apparent by the number of times your daily work has been interrupted by having to chase customers for accounts receivable, deposits, or payments due on unclaimed work.

Before we get into the remedies, let's go over some basics so we will be sure we're talking about the same conditions.

Several reasons why monitoring your cash flow is so important.

FIRST

It helps you to identify any cash shortages that may be looming. No one likes unpleasant surprises.

By regularly checking your cash inflows and outflows, you can see whether there are gaps between the two that could indicate potential problems.

For example, if your accounts receivable (i.e., money owed to you by customers) is much higher than your accounts payable (i.e., money you owe to suppliers), this could indicate you're not collecting payments from customers in a timely manner, which could lead to cash shortages.

SECOND

Monitoring your cash flow will help you to plan for future expenses. By understanding your cash inflows and outflows, you will see when your cash reserves are likely to be low and plan accordingly. This is the beginning of cash flow forecasting.

For example, if you know your accounts payable will be due at the end of the month and you don't have enough cash to cover them, you will take steps to generate more cash (e.g., by offering discounts for early payment, dipping into a line of credit, or taking out a short-term loan) to ensure you will pay your bills on time.

THIRD

Monitoring your cash flow will help you to identify areas where you can cut costs. This will have a very large impact on your cash. By reviewing your inflows and outflows, you will see where your money is going and identify areas where you may be able to reduce expenses.

For example, if you see you're spending a lot of money on marketing but not generating new business from it, you may decide to reduce your marketing expenses and focus on other areas of your business generating more revenue.

There are several tools and methods you will use to monitor your cash flow. One approach is to create a cash flow statement, which is a financial statement showing the amount of cash coming into and going out of your business over a particular period of time (e.g., a month or a quarter).

This statement typically includes information about your cash inflows (e.g., sales revenue, loans, investments, sale of assets) and your cash outflows (e.g., payroll,

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rent, supplies, monthly expenses), as well as any changes in your cash balance (e.g., from borrowing or repaying loans).

Another helpful tool for monitoring cash flow is a cash flow forecast. This is a projection of your future cash inflows and outflows, based on your past performance and any anticipated changes (e.g., new product launches, changes in market conditions). My recommendation is to set this up for a 13-week view. This is extremely helpful for looking ahead, instead of reacting to events as they present themselves.

It's also very helpful in avoiding the temptation to spend money in the account that has future commitments against it. This happens very often when a business is not up to date on their bookkeeping. When they turn their books in at the end of the year, the profit and associated taxes due are a complete surprise to the owner. What follows is the desperate dash to scrape together enough cash to pay the tax bill due.

By creating a cash flow forecast, you will anticipate potential cash shortages and take steps to mitigate them well before they become a problem.

IN SUMMARY

Monitoring your cash flow regularly is critical to the success of your small business. By keeping track of your cash inflows and outflows, you will identify potential cash flow problems, plan for future expenses, and identify areas where you can cut costs.

By taking a proactive approach to managing your cash flow, you ensure the long-term financial health of the business.

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ACCELERATING CASH COLLECTION

Accelerating cash collection is an essential aspect of managing small business finances. By encouraging customers to pay their invoices promptly, you will improve cash flow and reduce the risk of cash flow problems.

In this regard, offering incentives such as discounts for early payment or penalties for late payment is one effective way to encourage timely payment.

COVID provided one of the most powerful tactics is to align with the changes in buying practices being driven by online ecommerce practices. Virtually all online vendors require full payment at the time the order is placed. This common practice now and consumers have come to expect payment at the time the order is placed.

One of the most common reasons for late payment is the customer's cash flow problems. This needs to be expected and assumed until proven otherwise. Cash flow and Working Capital deficiencies are the rule and not the exception with small businesses. If you do B2B transactions with other small businesses, take heed.

Customers who are caught in this dilemma will prioritize their own cash flow needs to over those of their suppliers, resulting in delayed payments. If you are the supplier, you will always wait.

It may be possible to overcome this by offering discounts for early payment. You will incentivize customers to prioritize your payment over other expenses. For example, you may offer a 2% discount on the total invoice amount if the customer pays within 10 days of receiving the invoice.

If you do offer a discount, make sure it is a for a cash payment. If the customer pays by credit card, you will be paying an additional 3% to the credit card company in addition to the discount you are offering.

This discount can be an effective way to motivate customers to pay promptly and reduce the risk of delayed payment.

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On the other hand, charging penalties for late payment can also be an effective way to encourage timely payment. You may charge a penalty of 1-2% per month on any overdue amount, which can help to discourage late payment and incentivize customers to pay on time.

Check the laws in your state as to how much you can legally charge. Also be away the intent to levy late fees, interest, or penalties must be clearly stated on your contract, bill of sale, or invoice at the time the order is transacted.

If you are doing business online, the policy can be included in the link to your Terms of Service (TOS.) By placing the order, the customer will be agreeing to your TOS if you include notice on the order page.

It's important to communicate your policies around late payment penalties clearly, so customers understand the consequences of not paying on time.

Another way to speed up cash collection is to use electronic invoicing or online payment systems. This would be ACH payment, eChecks, Zelle, Venmo, and similar direct debit services.

Electronic invoicing involves sending invoices digitally, rather than through the mail, which will reduce the time it takes for the invoice to reach the customer. Most modern online invoicing through SaaS services will include direct payment links on the invoice to your linked payment processor.

Online payment systems, such as PayPal or Stripe, enable customers to pay their invoices quickly and easily using a credit card or other digital payment method.

These systems can also automate the payment process, sending payment reminders to customers and providing real-time updates on payment status.

Be aware, using these services will cost anywhere between 2% - 3.5% of the invoice total. This will add up to a considerable amount on larger invoices.

In addition to these strategies, there're several other best practices that will help you speed up cash collection:

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PROVIDE INVOICE AT THE TIME OF ORDER PLACEMENT

When working with large companies, schools, or customers with established credit terms, having your billing systems prepared and ready in real time is the essential first step.

It is extremely common for work to be completed and shipped before the paperwork is done. This is further compounded when the office staff delays the final invoicing for several days, or even weeks.

This is a very common problem for growing businesses without adequate systems or processes. Part of the issue is not wanting to do the administrative part of the job, so it gets put off until the end. Often the paperwork isn't completed until a cash crisis is looming.

Providing a completed invoice at the time of delivery is essential in getting the payment cycle started.

CLEARLY COMMUNICATE PAYMENT TERMS

Communicate your payment terms clearly to customers, including the due date and any penalties for late payment. Make sure customers understand their payment obligations upfront, so There're no surprises when the invoice arrives.

Small business owners are often embarrassed or too shy to push for payment collection. If you are a local business, blame it on Amazon. Simply tell the customer you are having a hard time completing with online sellers and if the appreciate doing business with a real live person, they know, like, and trust, you require payment with the order. This is what all the online providers require.

FOLLOW UP ON OVERDUE PAYMENTS

Keep track of overdue payments and follow up with customers who are late in paying. A friendly reminder can be an effective way to prompt customers to pay their invoices.

Better yet, follow up a day or two after the order is delivered to make sure everything is good and correct. Verify the invoice has been entered into their system and ask when it is due to be paid.

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If the client is on NET terms, follow up 3-5 days before the payment is to be released and confirm it is in the scheduled release run.

OFFER PAYMENT PLANS

If a customer is experiencing cash flow problems, consider offering a payment plan that allows them to pay the invoice over a period of time. This can help to maintain the customer relationship and reduce the risk of non-payment.

This option needs to only be used in unusual cases as a way of accommodating the customer.

MONITOR ACCOUNTS RECEIVABLE

Monitor your accounts receivable regularly to ensure that you're receiving payments on time. If you notice any trends or issues, take corrective action promptly to avoid cash flow problems.

Accounts Receivable Days of Sale, also known as Days Sales Outstanding (DSO), is a financial metric used to measure the average number of days it takes for a business to collect payments from its customers after a sale is made. This metric is important for businesses to track because it can help them identify potential cash flow problems and make adjustments to their operations.

To calculate Accounts Receivable Days of Sale, you first need to determine your average accounts receivable balance for a specific period of time, such as a month or a quarter. This can be done by adding up the accounts receivable balances at the beginning and end of the period and dividing by two.

Once you have your average accounts receivable balance, you can calculate your Accounts Receivable Days of. The formula for calculating Accounts Receivable Days of Sale is as follows:

Accounts Receivable Days of Sale = (Average Accounts Receivable Balance ÷ Total Credit Sales) x Number of Days in Period

For example, let's say a business has an average accounts receivable balance of $50,000 for the month of May, and its total credit sales for May were $150,000. May has 31 days. To calculate its Accounts Receivable Days of Sale for May, the business would use the following formula:

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Accounts Receivable Days of Sale = ($50,000 ÷ $150,000) x 31 Accounts Receivable Days of Sale = 10.33 days

This means that on average, it takes the business 10.33 days to collect payments from its customers after a sale is made.

By tracking Accounts Receivable Days of Sale, businesses can identify trends in their cash flow and take action to improve their collections process.

For example, if the average number of days it takes to collect payments is increasing, the business may need to adjust its credit policies, offer incentives for early payment, or follow-up more frequently with customers who have outstanding invoices.

IN SUMMARY

Speeding up cash collection is critical to managing your business finances effectively. Offering incentives such as discounts for early payment or penalties for late payment can be an effective way to encourage timely payment.

Using electronic invoicing or online payment systems can also speed up the payment process. By following best practices and monitoring your accounts receivable, you can improve your cash flow and reduce the risk of cash flow problems.

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EXPENSE REDUCTION

Reducing expenses is a key aspect of managing the finances of a small business. By reviewing expenses regularly, small business owners can identify areas where costs can be cut, and resources can be redirected to more productive activities.

This can help to improve profitability, free up cash flow, and ensure the long-term financial health of the business. Several strategies small business owners can employ to reduce expenses:

RENEGOTIATE SUPPLIER CONTRACTS

One of the most effective ways to reduce expenses is to renegotiate supplier contracts. This involves contacting suppliers and negotiating better terms, such as lower prices or longer payment terms.

This could include case pricing on all orders or free shipping above a certain amount. You can also increase your influence by agreeing to have the supplier be the first choice on all orders AND give them the opportunity to price match any other vendor.

By shopping around and comparing prices from different suppliers, small business owners can identify the most cost-effective options. This is useful information for the negotiation process.

ADJUST INVENTORY LEVELS

Another strategy for reducing expenses is to reduce or eliminate inventory levels. Unused stock is costing you money and ties up your working capital.

This can help to free up cash flow and reduce the costs associated with storing and managing inventory as well as inventory loss due to spoilage over time.

Small business owners can accomplish this by using inventory management software to track inventory levels and forecasting demand, so that they only order the inventory they need to, when they need to it.

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OUTSOURCE NON-CORE ACTIVITIES

Small business owners can also reduce expenses by outsourcing non-core activities, such as accounting or IT support, to third-party providers.

This can help to reduce labor costs and free up time for small business owners to focus on core business activities. It is becoming a very common practice in the "Gig Economy" post COVID. So many workers would rather work remotely on their own time as a virtual contractor.

With the increasingly connected world, it is becoming more and more common to outsource specific technical work to India, the Philippines, Mexico, and other low-cost English-speaking countries. Do some research into the possibility of outsourcing elements of your busines.

REDUCE ENERGY COSTS

Small business owners can also reduce expenses by reducing energy costs.

This can involve installing energy-efficient LED lighting, turning off equipment when not in use, and using programmable thermostats to regulate heating and cooling.

Local energy providers will assist in conservation programs and may even have assistance for different programs like solar panel installation.

USE CLOUD-BASED SERVICES

Small business owners can also reduce expenses by using cloud-based services, such as cloud storage or software as a service (SaaS) applications.

This can help to reduce the costs associated with maintaining and upgrading hardware and software.

The downside of this approach is most of these are subscription services either on a monthly or annual basis. While there can be substantial savings going to SaaS services, there is a danger of oversubscribing to them and then forgetting you subscribed. To avoid this, there are apps that monitor your subscriptions and alert you when they are coming due for renewal.

IMPLEMENT LEAN PRINCIPLES

Small business owners can also reduce expenses by implementing lean principles, which involve eliminating waste and increasing efficiency.

Lean principles are a set of management practices focusing on eliminating waste and maximizing efficiency in order to improve quality, reduce costs, and increase customer satisfaction.

Here are three examples of how implementing lean principles can reduce costs:

STREAMLINING PROCESSES

One of the core principles of lean is to streamline processes by identifying and eliminating non-value-added steps. This includes waiting times between processing steps.

By reducing waste and streamlining processes, businesses can increase productivity and efficiency, reduce errors and defects, and improve overall quality.

This can lead to cost savings by reducing the need to for rework, overtime, and other unnecessary expenses. The biggest advantage is the saving of time, which cannot be renewed. Making more time available means you can bill more work in the same period.

CONTINUOUS IMPROVEMENT

Another key principle of Lean is continuous improvement.

By constantly seeking to improve processes and eliminate waste, businesses can achieve long-term cost savings.

By identifying areas of inefficiency or waste, businesses can make targeted improvements that lead to cost savings .

This can be done through a variety of techniques, such as value stream mapping, kaizen events, and employee suggestions.

JUST-IN-TIME INVENTORY

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A third way that Lean principles can reduce costs is by implementing just-in-time inventory systems.

Just-in-time inventory involves producing and delivering products and materials just in time to meet customer demand, without the need to for large inventories.

This can reduce the need to for storage space, minimize waste, and improve cash flow by reducing the amount of capital tied up in inventory.

By implementing just-in-time inventory, businesses can reduce their costs associated with inventory management, such as storage, handling, and obsolescence.

JIT Inventory practices can have a significant impact on cash flow by reducing the need to purchase and hold inventory prior to use.

A different take on this would be to establish, separate vendor inventory ON SITE in a segregated area. The customer would only draw product when they were ready to use it. They would be billed monthly, but only on what they used as they use it.

NEGOTIATE PAYMENT TERMS

Small business owners can also negotiate payment terms with customers to improve cash flow. This can become a very creative approach that can have a significant positive impact on cash flow.

The most common approaches involve offering discounts for early payment or charging penalties for late payment. This is only the beginning of possibilities

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USE SOCIAL MEDIA FOR MARKETING

Small business owners can also reduce expenses by using social media for marketing, which can be a cost-effective way to reach customers.

There are many different strategies where Social Media can be used to build connected communities of customers or like-minded prospects. This can be a very effective method of low to no cost lead generation.

By leveraging social media platforms such as Facebook, Twitter, and Instagram, Tic Tok, and LinkedIn, small business owners can promote their products and services without spending a lot of money on advertising.

EVALUATE STAFFING LEVELS

Small business owners can also evaluate staffing levels to identify opportunities to reduce labor costs. It helps to know how many employees are need toed for a business of any size. This is usually a ratio of employee labor to Gross Margin. A good rule would be to have labor 25% -33% of the Gross Margin amount.

This can involve hiring part-time employees or outsourcing work to freelancers, independent contractors, or gig workers rather than hiring full-time employees.

REVIEW SUBSCRIPTION SERVICES

Finally, small business owners can reduce expenses by reviewing subscription services and canceling those that are not being used or are no longer necessary. This can cover a broad range of online and offline services.

This can help to reduce the costs associated with software, web hosting, Internet, cleaning, gardening, rags, beverage and other services.

IN SUMMARY

Reducing expenses is a critical aspect of managing the finances of a small business.

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By reviewing expenses regularly and identifying areas where costs can be cut, small business owners can improve profitability, free up cash flow, and ensure the long-term financial health of the business.

The challenge with reducing expenses is to go too far. If you cut too deep or substitute cheaper raw materials for your processes, you may compromise the quality and reliability of the work you do. Often this is not apparent until well into the cost reduction program.

To learn more about your full profit potential:

STRATEGIES FOR REDUCING EXPENSES

1. Renegotiating supplier contracts,
2. Reducing inventory levels,
3. Outsourcing non-core activities,
4. Reducing energy costs,
5. Using cloud-based services,
6. Implementing lean principles,
7. Negotiating payment terms,
8. Using social media for marketing,
9. Evaluating staffing levels, and
10. Reviewing subscription services

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INVENTORY MANAGEMENT

Managing inventory is an important aspect of managing the finances of a small business. Inventory refers to the goods that a business purchases or produces in order to sell to customers.

Managing inventory levels carefully is crucial to avoid tying up cash in excess stock, which can lead to cash flow problems and reduced profitability.

In this regard, small business owners can use inventory management software to track stock levels and forecast demand.

Inventory management software is designed to help businesses manage their inventory levels more effectively.

This software typically provides real-time information about stock levels, sales trends, and customer demand. T

his information can be used to make informed decisions about inventory levels, such as when to order new stock, how much to order, and which products to prioritize.

One of the key benefits of using inventory management software is that it can help small business owners avoid overstocking.

Overstocking can tie up cash and reduce profitability, as excess inventory may need to be sold at a discount or may become obsolete.

By using inventory management software to track stock levels and forecast demand, small business owners can order the right amount of inventory at the right time, which can help to reduce the risk of overstocking.

Another benefit of using inventory management software is that it can help small business owners optimize their inventory levels.

This involves balancing the costs of holding inventory (e.g., storage, handling, and insurance) with the benefits of having sufficient inventory to meet customer demand.

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By analyzing sales trends and customer demand, small business owners can determine the optimal level of inventory to maintain, which can help to reduce costs and improve profitability.

Inventory management software can also help small business owners to identify slow-moving or obsolete inventory. Slow-moving inventory is inventory that's not selling as quickly as expected, while obsolete inventory is inventory that is no longer in demand or even usable.

By identifying slow-moving or obsolete inventory, small business owners can take steps to reduce their inventory levels and free up cash flow.

In addition to using inventory management software, here are several best practices small business owners can employ to manage their inventory more effectively:

CONDUCT REGULAR INVENTORY AUDITS

Regularly auditing your inventory can help you to identify discrepancies between your physical inventory and your inventory records. This can help you to avoid overstocking and reduce the risk of theft or loss.

FORECAST DEMAND

By analyzing sales trends and customer demand, you can forecast how much inventory you will need to meet customer demand. This can help you to order the right amount of inventory at the right time, which can help to reduce costs and improve profitability.

Where this is particularly important is with finished goods inventory. In this example all costs have been incurred and paid for, yet no sales have been charged to the inventory. This is money sitting on the shelf!

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USE JUST-IN-TIME INVENTORY

Just-In-Time (JIT) inventory involves ordering inventory only when it is need toed, rather than holding inventory in stock. This can help to reduce storage costs and improve cash flow.

IMPLEMENT A FIRST-IN, FIRST-OUT (FIFO) SYSTEM

A FIFO system involves selling the oldest inventory first, which can help to reduce the risk of obsolescence and reduce the cost of holding inventory.

EVALUATE SUPPLIERS

Evaluating suppliers can help you to identify suppliers that offer the best prices, delivery times, and quality. This can help you to reduce the cost of purchasing inventory and improve profitability.

IN SUMMARY

Managing inventory is an important aspect of managing the cash flow of a small business.

Using inventory management software to track stock levels and forecast demand can help small business owners to avoid overstocking, optimize their inventory levels, and identify slow-moving or obsolete inventory.

Best practices for managing inventory can include conducting regular inventory audits, forecasting demand, using JIT inventory, implementing a FIFO system, and evaluating suppliers.

By managing inventory effectively, small business owners can improve their cash flow and profitability and ensure the long-term financial health of their business.

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NEGOTIATED TERMS

Negotiating payment terms with suppliers is an effective way for small businesses to manage their cash flow.

By negotiating longer payment terms, small business owners can free up cash for other uses and improve their overall financial health.

In this regard, it’s important for small business owners to understand the benefits of negotiating payment terms and how to do it effectively.

The benefits of negotiating payment terms with suppliers are many. By extending payment terms, small business owners can conserve their cash flow and have more flexibility to invest in other areas of their business.

This can be especially important for small businesses that have limited access to credit or are experiencing cash flow problems.

Negotiating payment terms can also help to build stronger relationships with suppliers, which can lead to more favorable pricing and other benefits over time.

To negotiate payment terms effectively, small business owners need to follow a few best practices:

BE PREPARED

Before entering into negotiations with suppliers, small business owners need to do their research and understand the market conditions, pricing trends, and other relevant factors that may affect payment terms.

They need to also be clear about their own financial needs to and goals.

UNDERSTAND THE SUPPLIER'S NEEDS TO

Small business owners need to take the time to understand the supplier's needs to and constraints, such as cash flow needs to, inventory levels, and production schedules.

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By understanding the supplier's perspective, small business owners can identify areas where they can offer concessions or trade-offs to achieve more favorable payment terms.

BE FLEXIBLE

Negotiating payment terms is a process of give-and-take, and small business owners need to be prepared to offer concessions or trade-offs in order to achieve their goals.

This may involve agreeing to higher prices in exchange for longer payment terms or agreeing to purchase larger quantities in exchange for more favorable payment terms.

COMMUNICATE CLEARLY

Effective communication is key to successful negotiations. Small business owners need to be clear and concise in their communications with suppliers and be prepared to listen actively to the supplier's perspective.

By communicating clearly and respectfully, small business owners can build stronger relationships with their suppliers and achieve more favorable payment terms over time.

IN SUMMARY

Negotiating payment terms with suppliers is an effective way for small business owners to manage their cash flow and improve their overall financial health.

By following best practices for negotiating payment terms, small business owners can achieve more favorable terms and build stronger relationships with their suppliers.

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USE CREDIT WISELY

Using credit wisely is an important aspect of managing the finances of a small business. Credit cards and other forms of credit can be a valuable tool for managing cash flow and financing growth, but they can also be a source of financial stress if not used judiciously.

In this regard, small business owners need to understand the benefits and risks of using credit, as well as how to use credit wisely to avoid high interest charges and penalties.

Credit cards can be VERY dangerous to use. They have extensive and complicated contractual terms that change constantly. The most dangerous aspects are the trigger clauses that activate if you are late on a payment, miss a payment, or if your credit score changes in a certain way.

This can change the effective interest rate from something very reasonable, to one that's approaching 30% annually or MORE.

The benefits of using credit for small businesses are many. Credit cards and lines of credit can provide small businesses with access to cash when they need to it.

This allows them to manage cash flow more effectively and make investments in their business. Credit can also help small businesses to build credit history, which can be important for securing future loans or lines of credit.

However, there're also risks associated with using credit. As previously mentioned, high interest rates and fees can quickly add up, especially if small business owners carry a balance from month to month.

To use credit wisely, small business owners need to follow a few best practices:

UNDERSTAND THE TERMS AND CONDITIONS

Before using credit cards or other forms of credit, small business owners need to read and understand the terms and conditions of the credit agreement. This includes the interest rates, fees, and penalties associated with the credit. Also be aware that these terms can be changed at any time.

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USE CREDIT JUDICIOUSLY

Small business owners need to use credit judiciously, only using it for necessary expenses and avoiding using it to finance long-term investments or speculative activities.

PAY BILLS ON TIME

Owners need to pay bills on time to avoid high interest charges and penalties. Late payments can also damage credit scores, making it harder to secure future credit.

KEEP BALANCES LOW

Small business owners need to keep credit card balances low, ideally paying off the balance in full each month. This can help to avoid high interest charges and reduce the risk of carrying a balance from month to month.

MONITOR CREDIT SCORES

Monitor credit scores regularly to ensure they are in good standing. This can help to identify any issues or errors that need to be addressed and can also help small business owners to build credit history over time.

It's also helpful to know in advance the consequences to your fees and interest if your credit score changes. Often, they will degrade and never return to pre- event levels.

IN SUMMARY

Using credit wisely is an important aspect of managing the finances of a small business. Small business owners need to understand the benefits and risks of using credit, as well as how to use credit wisely to avoid high interest charges and penalties.

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CREATE A CASH FLOW FORECAST

Creating a cash flow forecast is a necessary and important tool for small business owners to manage their finances and plan for future growth.

A cash flow forecast is a projection of a company's future cash inflows and outflows over a specific period of time, typically one year. At the very minimum it needs to forecast ahead 13 weeks.

By developing a cash flow forecast, small business owners can anticipate cash flow problems, plan for future growth, and identify potential funding needs in advance.

It has been my experience working with companies who have implemented this step that cash flow quickly comes under control. There are two reasons for this. The first is anything measured gets improved.

The second is awareness leads to peace of mind. When you have a good idea what is ahead, it’s much easier to be proactive than reactive. I’ve also found that this awareness leads directly to a better understanding of the role of Gross Margin in the business operation.

Let’s go deeper. There are several benefits to creating a cash flow forecast:

ANTICIPATE CASH FLOW PROBLEMS

By projecting future cash inflows and outflows, small business owners can anticipate cash flow problems before they occur. This can help them to take proactive steps to address these issues, such as negotiating payment terms with suppliers or implementing a more aggressive collections process with customers.

PLAN FOR FUTURE GROWTH

A cash flow forecast will help small business owners to plan for future growth by identifying potential cash flow gaps that may arise as the business expands. This will help them to anticipate funding needs and identify opportunities to generate additional revenue. This is especially important if automation is planned as part of

business expansion. The necessary increase in Working Capital is essential in fully realizing the efficiencies and increased production automation enables.

IDENTIFY POTENTIAL FUNDING NEEDS

Cash flow forecast can help owners identify potential funding needs to in advance, such as the need to for a line of credit or a business loan. This can help them to plan for these needs to and identify the most appropriate financing options.

To create a cash flow forecast, small business owners need to follow a few best practices:

COLLECT ACCURATE DATA

To create an accurate cash flow forecast, owners need to collect accurate data on their past cash inflows and outflows. This can be done by reviewing bank statements, sales data, and other financial records.

Initially this may present a problem as records are out-of-date from delayed financial reporting. Another challenge is the necessary information to build an accurate forecast is simply missing or not recorded or classified.

Realistically, it can take up to 3 months to fall into a normal, predictable pattern. The process or aligning to create an accurate statement raises awareness and naturally makes implementing easier.

USE CONSERVATIVE ESTIMATES

When creating a cash flow forecast, small business owners need to use conservative estimates for their cash inflows and outflows. This will help to ensure they have a realistic understanding of their cash flow situation and will plan accordingly.

It's not uncommon to forecast periods of significantly negative cash flow. This is normal and to be expected. This is exactly why a business struggles with cash management. They simply are not watching carefully enough. Looking at the daily cash balance in the bank account is not sufficient.

Having a cash flow spreadsheet that looks forward at least 13 weeks will be a God send. It is especially useful when negative numbers are conditionally formatted to be in BOLD RED so they jump out.

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In the beginning, these negative numbers will be the norm and will appear frequently. This awareness will change the way orders are handled, cash is collected, and purchases made. It does not take long to make a positive change.

UPDATE THE FORECAST REGULARLY

Small business owners need to update their cash flow forecast regularly to reflect changes in their business, such as new customers, new expenses, or changes in market conditions. This will help them to identify potential cash flow problems early and take action to address them.

The updating needs to happen at minimum on a weekly basis. To be able to achieve this, financial information, invoicing, and cash collections need to be done on a daily basis. This is a require practice to achieve peace of mind around the cash requirements of the business.

CONSIDER DIFFERENT SCENARIOS

Small business owners need to consider different scenarios when creating a cash flow forecast, such as best-case, worst-case, and most likely scenarios. The scenarios are usually based on the expected time of cash receipts and payments. This will help them to identify potential risks and opportunities and plan accordingly.

Having a working version of the Cash Flow Statement will allow for the planning and experimentation of cash planning. Significant changes are possible with very little effort once a business owner becomes familiar with what can and cannot be changed.

IN SUMMARY

Creating a cash flow forecast is an essential tool for small business owners to manage their finances and plan for future growth. It is the most commonly missing element of financial management

Small business owners need to collect accurate data, use conservative estimates, update the forecast weekly, and consider different scenarios when creating a cash flow forecast.

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8
FOCUS ON PROFITABLE WORK

Focusing on profitable products and services is the next essential component of managing cash flow for small businesses. This is an area that may seem obvious and logical, but there are hidden challenges within.

By concentrating on the products and services that generate the most profit, small business owners will maximize their cash flow, reduce the risk of cash flow shortfalls, and improve overall financial health.

There are three key components to generating maximum profit.

FIRST

Make sure the jobs or engagements are big enough to be profitable. For most small businesses the gross margin created needs to be in the $250-$300 range. This is the starting point and can be adjusted once the true numbers are known.

It is extremely common to see 50% or more, of all jobs falling well below this number. Gross margin is the calculated as Sales – Cost of Goods Sold (COGS) = Gross margin.

As owners begin to look at their cash flow, there is a natural denial around the realization that 50% or more of their work is not profitable. Be perfectly clear, I am not advocating the immediate termination of this work.

It needs to be managed over time. The most logical approach is to discontinue the very small jobs immediately. The next step is to institute a minimum job size. This can be done over a series of steps and communicated to the customer base over time, typically 3-6 months.

Finally, raise the price on work that is close to being profitable to make it profitable. This can be done in two ways. The first is to raise the actual price of the unit of work. The second is to increase the number of units to reach the point where the work is profitable. This may take some creativity but is almost always achievable.

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SECOND

Record the time it takes to produce the work. Gross Margin ÷ Time is the hidden factor that is almost always overlooked. It is a frequent conversation with an owner who says, " I have great margins on the work we do."

On further investigation, the value quickly evaporates on the small jobs when it turns out it takes hours to do the jobs. For instance, a job with $500 of Gross margin that takes an hour to produce is a completely different situation than a $500 GM job that takes four hours to produce.

When you do not cover the cost per hour to operate, the difference is now added to the remaining time in the month, increasing the amount of GM that must be recovered. This always leads to a serious under-estimate of the true cost to run the business, and the frustration of low, or no end of month profit.

This hidden factor is one of the keys to radically improving profit in a business. Simply schedule the jobs having higher GM/Hr value FIRST and schedule the remaining work in descending order of GM value. This will result in achieving Breakeven (BEP) earlier in the month. At the point in the month where BEP happens, 100% of the GM becomes pure operating profit from that point on.

THIRD

Awareness of where the cash is coming from allows the owner, and sales & marketing to make smarter decisions about the kind of work being sold and accepted.

It is very common for the sales team to accept ANY kind of order because it moves them closer to their top line sales quota. This is not the right number to be tracking. Sales needs to be tracked based on minimum Gross margin, and ideally Gross margin/time to produce.

The awareness around this critical concept will quickly align the sales effort with effective, profitable, cash flow positive growth.

It is amazing to watch the transformation of companies who move to adopt this perspective. Owners are often surprised at how easy it is to make the transition.

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Several benefits to focusing on GM/Hr profitable products and services:

MAXIMIZE CASH FLOW

By focusing on profitable products and services, owners will maximize their cash flow by directing resources towards the areas of the business generating the right kind of profit. This will ensure the business has sufficient cash flow to meet its obligations and invest in future growth.

REDUCE THE RISK OF CASH FLOW PROBLEMS

By prioritizing profitable products and services, small business owners can reduce the risk of cash flow problems by avoiding investments in areas of the business that may not generate sufficient returns.

This can help to ensure the business has the cash flow need to cover its expenses and maintain its operations.

IMPROVE OVERALL FINANCIAL HEALTH

By focusing on profitable products and services, small business owners can improve the overall financial health of their business by increasing profitability and generating more cash flow.

It is important to also consider the collection time for the Accounts Receivable once the job is completed. I am an advocate of payment in advance for all work. This makes it much easier to calculate available margin and cash to run the business.

This will help to provide a stronger financial foundation for the business and make it more resilient in the face of economic uncertainty.

To focus on profitable products and services, small business owners need to follow a few best practices:

ANALYZE PROFITABILITY

Small business owners need to analyze the profitability of their products and services regularly to identify areas of the business that are generating the most profit. This can be done by tracking sales and expenses for each product or service and calculating the profit margins.

Besides the previously mentioned GM/Hr formula, consider how long the customer typically takes to pay. Another element is how easy the customer is to work with.

Clients who are difficult, demanding, and high drama have a more negative impact on company moral. It is far too common to accept this type of client due to the low profit profile of the company.

ELIMINATE UNPROFITABLE PRODUCTS & SERVICES

Owners need to consider eliminating products and services that are not generating sufficient profit. This will help to free up resources that can be directed towards more profitable areas of the business.

When the value of Time is including in the evaluation and decision-making process, the impact on profitability will be significant.

INVEST IN PROFITABLE PRODUCTS AND SERVICES

Invest in products and services that generate the most profit by allocating resources towards marketing, product development, and other activities that will help drive growth.

Consider the impact on the RESULT you deliver and not the product or service at face value. This is one of the key perspectives profitable companies engage in.

ENCOURAGE PRE or EARLY PAYMENTS FROM CUSTOMERS

Offering incentives for prepayment or early payment, such as discounts or other benefits, will improve cash flow and reduce the risk of late payments.

Rather than offering direct discounts, include bonuses of additional services or other value-added elements. With a little creativity, this will add significant perceived value, without adding additional cost.

For instance, for customer who is prepaying, offer earlier delivery. You are doing exactly the same work, for the same amount, but you are offering preferred delivering at the front of the line.

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NEGOTIATE PAYMENT TERMS WITH SUPPLIERS

Negotiating longer payment terms with suppliers can help to free up cash flow and improve overall financial health.

MANAGE EXPENSES CAREFULLY

Reviewing expenses regularly can help small business owners identify areas where costs can be cut and resources can be redirected to more productive activities. This is important because expenses are often seasonal or cyclical.

MONITOR INVENTORY LEVELS

Careful management of inventory levels can help small business owners avoid tying up cash in excess stock and reduce the risk of overstocking.

IN SUMMARY

Focusing on profitable products and services is an important strategy for small business owners to manage their cash flow and improve overall financial health.

Small business owners need to analyze profitability regularly, eliminate unprofitable products and services, invest in profitable products and services, and monitor market trends.

By managing their cash flow effectively, small business owners can ensure the long-term success of their business.

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9
FINANCING AS A LAST RESORT

For small businesses, managing cash flow is critical to their success. One way to address cash flow shortfall is to consider financing options such as loans, lines of credit, or factoring.

These financing options can provide small businesses with access to cash when they need it, allowing them to manage cash flow more effectively and make investments in their business.

However, it's important for small business owners to understand the costs and terms associated with each option before making a decision.

LOANS

A loan is a type of financing where a lender provides the borrower with a lump sum of cash that must be repaid over a set period of time with interest.

Loans can be secured or unsecured and can be used to finance a wide range of business expenses. Small business owners need to carefully consider the interest rates, fees, and repayment terms associated with a loan before making a decision.

There are different types of loans specifically designed to increase working capital to help manage cash flow. A very typical SBA

LINES OF CREDIT

A line of credit is a type of financing where a lender provides the borrower with access to a set amount of credit that can be used as need toed.

Interest is only charged on the amount of credit that is used, and repayment terms are typically more flexible than with a loan. Small business owners need to carefully consider the interest rates, fees, and repayment terms associated with a line of credit before making a decision.

The terms of the Line often include a requirement to rest the Line for a period of 30 days once a year. This means the balance needs to be zero for a period of 30 continuous days, once a year.

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Additionally, read the terms carefully around the provisions where the bank has the right to “call” the loan. This means, the bank requesting all drawn credit is due and payable to the bank.

This often happens when the bank becomes unstable financially or interest rates rise quickly and unexpectedly.

There is danger of that currently in 2023. Hundreds of banks called Lines of Credit in the wake of the 2008 credit crisis and it could definitely happen again.

FACTORING

Factoring is a type of financing where a business sells its accounts receivable to a third-party financing company at a discount in exchange for immediate cash.

This can be a useful option for businesses that have a high volume of accounts receivable and need to cash quickly. Small business owners need to carefully consider the fees and terms associated with factoring before making a decision.

When considering financing options, small business owners must consider their creditworthiness and ability to repay the debt. Lenders will typically evaluate a small business's credit score, financial statements, and business plan before approving a loan or line of credit.

The interest rate can be 2%-3% on the amount advanced against the invoices presented. Additional interest becomes due if the invoices are not paid on time. Factoring is very common in the apparel and fashion industry but is one of the most expensive financing options.

IN SUMMARY

Considering financing options is an important strategy for small business owners to manage their cash flow and make investments in their business.

Small business owners need to carefully consider the costs and terms associated with each financing option before making a decision.

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10
PROFESSIONAL FINANCIAL ADVISORS

Seeking the advice of a financial advisor or accountant can provide valuable insights and recommendations to help small business owners improve their financial performance and manage their cash flow effectively.

Be aware there are two types of accountants. The first, and most familiar are the Financial Accountants. They are focused on the review of operational performance that has already taken place. These are events that have already happened.

These are the most common as they create Profit and Loss Income Statements, Balance Sheet, and Cash Flow Statements. They also prepare taxes. The most important thing to remember is they are reporting the effects of activities that have already happened.

The biggest challenge is getting the information back to the business as quickly as possible. Ideally, you want all the statements prepared and delivered by the 10th of the following month. The longer you wait, the less meaningful they are to you.

The second type of accountant is the Managerial Accountant. This type of financial professional is concerned with helping to project or forecast future events. I call this "Break Lights on the Freeway."

They use the numbers on the financial statements to analyze performance and make decisions in advance of the actual events. This is the work of the Comptroller, Controller, or Chief Financial Officer. This role generally is not implemented in companies with revenues below $10 million per year. They are an essential role for any publicly traded company.

Make no mistake, these are incredibly valuable services that will benefit any small business owner, regardless of the size of their business. The only requirement is some basic knowledge of accounting and how it why you need to this kind of analysis.

Financial advisors and accountants can provide a range of services to small business owners, including:

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CASH FLOW ANALYSIS

A financial advisor or accountant can conduct a cash flow analysis to help small business owners identify potential cash flow problems and develop strategies to address them.

This is a critical step in determining if you have enough working capital to support the current level of operations or to support the anticipated growth of the company.

BUDGETING AND FORECASTING

Financial advisors and accountants can help small business owners develop budgets and forecasts to plan for future growth and anticipate potential funding needs to.

This includes the need to for additional working capital if automation is added to the business. Faster production, and increased efficiency can have very negative impact on cash flow if not properly planned for.

TAX PLANNING

Financial advisors and accountants can help small business owners develop tax planning strategies to minimize their tax liabilities and improve their cash flow.

These are essential services as the business grows and automates. Too many small businesses are caught completely unprepared to the tax burden they create for themselves. This is especially true when they experience rapid growth of if they land a big order.

FINANCING ADVICE

Financial advisors and accountants can help small business owners identify financing options that are best suited to their needs to and provide guidance on securing financing.

Advisory services in this area are clearly essential for the smooth growth of a maturing business. An experienced professional who understands all of the related rates and impacts of a balanced financial model will go a long way in providing clarity around the complex area of financial management.

RISK MANAGEMENT

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Financial advisors and accountants can help small business owners identify and manage financial risks, such as fluctuations in interest rates or changes in market conditions.

In the 2020’s this is going to be a critical element. With inflation at 40-year highs, interest rates are rising at historic rates. This cycle occurred in the late 1970’s and early ‘80’s resulting in credit rates of 21% for business lines of credit. Coming off of historic low interest pre COVID, this is an unexpected and negative shock to the cost of financing a busines.

A secondary impact of rising interest rates is the decline in available credit that can be used to finance operations and growth. This happened after the 2008 financial crisis as well, resulting in many well-established businesses going out of business when their Lines of Credit were called by the issuing banks and the businesses were not able to repay within the terms.

In addition to these services, financial advisors and accountants can also provide valuable insights and recommendations to help small business owners improve their financial performance and manage their cash flow effectively.

They can help small business owners develop financial strategies tailored to their specific needs to and goals and provide ongoing support and guidance as the business evolves.

When seeking the advice of a financial advisor or accountant, small business owners need to consider a few best practices:

CHOOSE AN ADVISOR WITH RELEVANT EXPERIENCE

Small business owners need to choose a financial advisor or accountant with experience working with businesses similar to their own.

This can help ensure the advisor has a deep understanding of the challenges and opportunities faced by small businesses in their industry.

A common problem is working with a financially oriented bookkeeper or CPA who is simply reporting on your past events. CPAs will commonly prepare taxes without any advisory guidance to the owner, other than how much tax is due or how much money the business lost in the previous year.

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Selection of a seasoned advisor is a critical step on overcoming cash flow issues. One of the most obvious clues you're working with the wrong provider is if they fail to provide a Cash Flow Statement. This is the critical third document that accompanies the Profit and Loss Statement and the Balance Sheet.

ESTABLISH CLEAR EXPECTATIONS

Small business owners need to establish clear expectations with their advisor regarding the services they will provide, the fees they will charge, and the timeline for completing work.

The requires responsibility and accountability on the part of the small business owner. It is simply too easy NOT to keep up with daily reporting and recording of financial activity. This is simply a must do for a successful business.

COMMUNICATE REGULARLY

Small business owners need to communicate regularly with their advisor to stay informed about their financial performance and make adjustments as need toed. Ideally this would be monthly at a minimum with deeper quarterly in-depth reviews.

BE OPEN TO FEEDBACK

Small business owners need to be opened to feedback and willing to consider the recommendations of their advisor, even if they may be difficult to hear. To aid in achieving this openness, follow these steps.

Start by approaching the financial advisor with "Help me understand why this is necessary in simple and understandable way."

Follow with "Tell me more. . ."

Complete with "Tell me why this is important." You may also summarize with "Let me make sure I understand this completely. . . " and then repeat your understanding.

Don't be alarmed or feel embarrassed if you don't get it right the first time. This is very common and one of the main reasons there is so much mystery around the numbers and the financial process. Your goal is to come away with a complete understanding of how important this step is.

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To make this a more valuable experience, owner my need to learn some fundamental accounting terms and understand how the financial information will work for them. Frequent follow-up and reinforcement of the financial aspects will not take long.

ENCOURAGE EARLY PAYMENTS FROM CUSTOMERS

Offering incentives for prepayment or early payment, such as discounts or other benefits, can help to improve cash flow and reduce the risk of late payments. The role of the advisor in helping to determine the required level of working capital is key in managing the cost of capital as it relates to discounts granted and late payment penalties paid.

IN SUMMARY

Seeking the advice of a financial advisor or accountant will provide small business owners with valuable insights and recommendations to help them manage their cash flow effectively and improve their financial performance.

Small business owners need to choose an advisor with relevant experience, establish clear expectations, communicate regularly, and be open to feedback.

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