Improving the Cashflow in Your Business

David Ross CA
Direction Accounting
www.direction.com.au
david@direction.com.au

So…What's the Problem?

We've all heard the saying Cash is King… but how many business owners out there are operating as if they are paupers?

Cashflow is the biggest cause of stress among small business owners. Too often are nights spent sleepless, thin king about where the next job is coming from, or how the next project is going to be funded.

So what are some key insights?

- The national average to get paid is currently 46 days.
- Worse still, most businesses don't know their Debtor Days.
- 88% of Businesses are paid late
- 33% say they don't pay due to a lack of funds..and
- 26% say they delay payment because others haven't paid them.

You see, without a conscious effort to improve Cashflow in your Business, you are on a hamster wheel, and normally running fast….very fast.

The only way to Achieve steady Cashflow surplus in our business is to look at the key drivers and design strategies around each.

So first, let's look at how we get more Cash in the first place.

We typically generate more cash by:

- Earning More
- Spending Less
- Accelerating Cash Inflows
- Delaying Cash Outflows.
- Increasing Debt
- Raising Investment

Most businesses focus on one or maybe two of these in isolation. In particular, the "chasing of outstanding accounts", one way of accelerating inflows, is the first, and sometimes the only focus.

But good Cashflow is so much more than what we call Bikies and Baseball Bats. Better Systems is the key.

Better Systems

As the most popular Go-to, chasing debts is the logical place to start. Having strong and consistently adhered to systems around offering credit to your customers is vital.

Does your Business have an up to date Terms of Trade document? Simply put, your Terms of Trade are the rules that both yourself and the customer agree to for letting them not pay you for a set period. They typically cover what happens in the event of late or non-payment, and are a vital document when things go sour.

The second key document and one which goes hand in hand with the Terms of Trade is the Credit Application. Strong credit applications will allow a business to capture accurate contact information as well as any guarantees. They also allow opportunity for credit checks to be performed.

Having better payment options can often help. Not just options such as credit card or After Pay, but also smart management, such as implementing upfront or progress payments, minimising any outstanding amounts post job completion/sale.

Once you have the debtors systems in place , you need to follow them consistently. And that means being honest with yourself…set aside the time and resources to do what you say you are going to do. He who shouts loudest, AND consistently, gets paid first.

And lastly, know when to call in the experts. Professional collection agents know how to extract the cash from recalcitrant payers. Sure you can do it yourself, but how much time and effort, not to mention stress is going to be involved. Pass it on to those that are best suited.

So how do we manage the Cash that is needed?

Understanding Current Needs

History is your friend here. Typically, cycles will repeat themselves within your business. Look at what has happened in the past and use this as one way of forecasting the future.

Planning your sales cycle or workflow also start here, but with a keen eye on estimates or known scheduling and capacity issues.

You may wish to build in contingencies. No-one benefits from a rosey forecast. Even your bank will see through to the reality. So be thorough in what your cashflow needs are going to be. After all, the planning is for you, no-one else.

Things to consider might be:

- Reliable flows like GST and PAYGW
- Monthly Direct Debits
- Understanding the difference between Cash and Profit.

Direction provides business clients with our "Where did the cash go" report when completing their year end tax. If you are interested in finding out where your Cash has gone, drop me a message, let's analyse your numbers and get you some real information that means something.

Forecasting..is it worth it?

We often talk about businesses with no plans being like going on holiday to a foreign country without any guidebook or map.

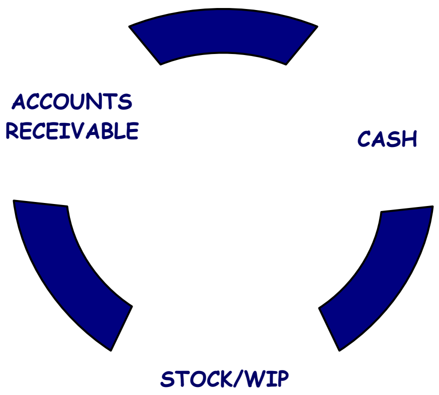
A forecast simply provides you with knowledge before the fact. Knowing when you are going to be short of funds is important in getting your lending facilities right. It also allows you to set sales targets or plan the capacity of your team.

The main pushback we get when it comes to forecasts is the concern over actual varying significantly to the forecast. It is therefore critical to have a dynamic forecast model, which can be altered quickly, as things change in real time.

Rolling forecasts are best practice. If you would like to discuss how these can be put together, get in touch with our team.

Your Cashflow Cycle

Business is pretty simple at it's core.



You use cash to buy materials or apply resources like labour to produce a product or service. You then sell that product or service to a customer. The customer then pays you and the cycle starts again.

Typically a business will have a cashflow gap between when they have to pay their bills and when they get paid. The bigger this cashflow gap, the worse the issue can become.

Interestingly though, if you have a cashflow gap when you are small, what happens when you grow?

That's right, the $ value of the gap gets bigger. The bigger you get, the bigger the gap you have to fund.

You may have heard the saying, growing yourself out of business. This what happens. You get bigger, your cashflow cycle expands, until the money to fund it dries up. BANG! Cashflow Crisis.

Understanding this phenomenon is critical when growing a business. The construction industry is particularly prone to this issue.

The cashflow cycle can alternately be shown on a timeline highlighting the days between each cashflow stage.

Day by Day

As Accountants, we love analysing the numbers. The documents that form your financials are a goldm ine of information regarding the performance of your business.

Key figures relevant to cashflow are:

- Debtor Days
- Inventory Days
- Creditor Days

Each of these measure the "Days" held of each item at any point in time.

For example: If your Debtor Days are 45 , that means that it takes 45 days on average for you to get paid.

Inventory Days measures the amount of Days stock you are holding. Too high a figure for Inventory Days typically means a high level of Cashflow tied up in stock, or even poor turnover of stock lines which can be a symptom of even wider problems.

The above are common ratios which are used as key cashflow health indicators.

We will not go into the exact calculation of each here, howeveer if you are not measuring these key numbers already, please get in touch with us for a Business Health Check.

So…What difference does a day make?

If your Debtor Days are say 90.

…and your Debtors are $90,000

Each day is worth 90,000/90 ie $1000

So if you could improve your Debtors Days by just 10 days to say 80, there is an extra $10,000 cash-flow improvement.

The same issue stands for inventory and improving stock levels.

The strategies to Achieve these changes are numerous and cannot be done justice in this short report, however please reach out to us if you are wanting to improve your "Days"

Cashflow Improvement is a topic covered in our "Superstars" Mastermind Program.

Superstars is a business group of like minded business owners, meeting on a monthly basis for 3 months to share, engage and inspire. Such groups bring together significant experience as well as *putting motivation into the equation through required preparation for meetings and sharing of broad category results. For more information on joining Superstars, contact our office.*

Pulling the right levers

By now yopu have probably gathered that cashflow improvement is not about one specific fix. You need to m ake changes in all facets of your business to get the maximum result.

To put some of the different methods into perspective, here are some real life examples of businesses suffering from cashflow issues and the varied solutions applied.

Inventory Overload

A client running a landscaping/homewares yard was complaining of poor cashflow. Upon review, over half of their revenue was held in stock. Given there profit margins, this was an alarming Inventory Days issue. Upon advising the client of the need to reduce stock, the client contested that if they did that, the yard site would be half empty.

Without the willingness to creatively stock the yard with reduced levels, the business quickly suffered the consequences and was closed voluntarily around 6 months later by the owners.

Disappointing that stubborn-ness sometimes overrides logic.

Lazy Sales

A retail building industry client suffering poor cashflow, could not self assess where they were going wrong.

Upon review of their conversion rates from quotes, it was discovered that they had poor follow up procedures and very few quotes to customers were being takeen through a consistent sales process.

As a result, sales were significantly down in comparison to their overhead structure. The Golden Rule of Cashflow is GET MORE PROFITABLE SALES.

More money in, solves the issue.

We set about working with the client to not only put in place tighter sales procedures but also work with the owners on what was stopping them from following up otherwise happy prospects.

Slow Turnaround Time/Billing

Professional Services firms, including accountants, have a concept of Lockup. Lockup is the addition of outstanding debtors and unbilled work (Work in Progress).

The particular Professional in question had a Lockup of 20% of their Revenue. In dollar terms, they had $1M lying dormant in their business, waiting to be realised.

Remember the cashflow Gaps? The bigger you get the bigger the hole you create Cashflow wise. Imagine having to fund $1M, due to poor management systems.

The key solution here was to adress workflow and collection/billing procedures. A monthly Accountability culture was also implemented.

Next Steps

There are many great products now available which can do alot of the heavy data lifting.

Cloud apps like Xero and Quickbooks online allow automation of billing and debtor management.

Outsourced services such as Debtor Daddy and Chaser also help streamline otherwise clunky systems.

A wide range of Payments Services such as Ezidebit and mobile invoicing/eftpos solutions have now made it easier than ever to get paid quicker.

However, all of that is irrelevant if you fail to monitor the key drivers of Cashflow in your business. And every business has different drivers.

Understanding your key ratios and what they m,ean to your business in $ terms.

Understanding your cashflow cycle, your Cashflow Gap and how you can manage it is critical.

And being held accountable to someone to actually get it done and provide you with assitance along the way is critical.

Direction Accounting and our Business Coaching arm Supercoach are experts in helping small business navigate these issues and determine what levers to pull to get results.

If you would like to discuss how to manage Cashflow bettter in your business with one of our team, head to our website at www.direction.com.au and make an appointment to run through your numbers. It's where it all starts, and it's where the magic happens.

But we would say that. We're Accountants after all!

Look forward to talking soon.

David Ross is a Chartered Accountant and Business Coach with over 25 years experience working with small business. David is the founder of Direction Accounting and SuperCoach - business coaches specialising in enhancing the knowledge and profits of business owners. Connect with David at david@direction.com.au or on Facebook: supercoachdavidross