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CA$H FLOW PLANNING

A healthy cash flow is the life blood of every business, more so when donors are in short supply. You may be the market leader, have award winning products or be voted a top 10 employer, but if you do not have enough cash to pay the bills, it goes without saying that you will not be in business very long.

Cash flow problems are widespread and are not only the concern of the small business owner. Long before the current financial crisis, many large businesses were in difficulty. In 2006, 50% of US airline seating capacity was receiving Chapter 11 bankruptcy protection.

For the majority of businesses, getting cash flow management right first time is business-critical. Running a business at full speed and neglecting the impact of cash is a fast track route to bankruptcy.

Whilst not all cash flow problems can be avoided, a large number can, and much of what is required is common sense.

Confusing profit with cash

It is important not to confuse cash with profit. You may be able to forecast a good profit for the year but still run into cash flow problems. When developing the annual budget, care should be taken to include a monthly cash flow forecast. It is important to understand and plan appropriately for the impacts of items such as these: seasonality, capital purchases, inventory purchases, long term contract work and insurance premiums.

An advanced view of the annual cash flow facilitates the ability to both maximise the returns on surpluses and to choose an appropriate way of funding deficits. Your profit forecast may well be aspirational, but your cash forecast must be realistic.

Throughout the year the cash flow forecast should be kept up to date and maintained on a rolling 12 month basis. Comparing actual performance against forecast is fundamental and should be carried out on a weekly basis. Be aware of changing market conditions and of any potential changes in your customer's circumstances; you will not always know for sure if your customers are in financial trouble until it is too late.

Trust your instincts: a run of customer invoice queries, mistakes with cheques, or refusing to return your calls could be warning signals. Having reassessed your environment, ensure any necessary changes are reflected in the cash flow forecast. Regular communications with your finance team may be necessary if you are to avoid reports devoid of reality and which are churned out on autopilot.

Rapidly growing businesses can experience a heavy cash burden. With profitable businesses it is easy to fall into the trap of neglecting cash requirements. Including cash management performance indicators in bonus schemes is a good way to retain focus.

A large number of your staff are perhaps able to recall last months sales figure, perhaps also the profit figure. However, how many would be able to recite any cash related statistics? Customer non-payment is commonly caused by a customer's dissatisfaction with the product or service. As many more staff are accountable for customer experience than for the sales process, it could be argued that the provision and knowledge of appropriate cash flow performance indicators is at least as important as sales and profit indicators.

Remember: "Sales are vanity, profit is sanity, cash is reality."

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Failing to understand the business

Investors and financial institutions use financial information to make decisions about your business. So should you. Company systems and staff possess a wealth of data. If well captured and analysed, it can provide invaluable information to improve cash flow and profitability. Without this information there is always a risk of 'busy fools' syndrome or even worse: taking on or continuing with customers, products or services which are damaging to cash flow and perhaps even to the sustainability of the business.

Many businesses have very weak management information systems and fail to understand which customers, products or services generate the best contributions and which could be causing losses. Extracting this information from the corporate systems is often overlooked, deemed unnecessary or perceived to be too difficult or time consuming an exercise. Given the potential value of this information, it could be worthwhile considering the support of an external provider. A well developed, MS Excel based automated reporting suite can provide a cost effective solution for many different sizes of business.

For companies with large overheads a further challenge is to understand what drives the company's overheads. This can often be assessed by taking a reasonably broad brush approach. Which customers, products and services are absorbing a directors' time? You can almost guarantee that time spent will be disproportionally skewed towards a minority of customers, products or services. The same will likely also be true for other overhead expenses such as accounting and invoice collection, marketing and perhaps even recruitment and training.

In assessing your overheads you will find that Pareto's principle applies (roughly 80% of the effects come from 20% of the causes). You may consider that there are good reasons to continue with these income streams. However, if 80% of your overheads are being driven by 20% of your income, then you should perhaps consider whether there is a need to terminate some customers or end some pet projects.

New products, new markets and diversification are all legitimate corporate strategies. Whether planned or opportunistic, such strategies can be a necessary addition to the core business. However, any deviations from the core business must be carefully thought through to protect the health of the business. New ventures incur a learning curve which can be expensive and distracting.

One-off immaterial ventures are often best avoided unless considered strategic. In cash-strapped times, the temptation to venture away from the core business may intensify but the health warning does not diminish. You must ensure that any new ventures or one-offs are carefully considered and that the associated cash flows are appropriately managed.

Ignoring problems

Businesses are never clueless about problems. The issue is not admitting the problem early enough or not seeking the appropriate help to address the problem. Entrepreneurs and business leaders are often strong willed, which can make it difficult to convince them that they have a problem and that changes are necessary.

Dismissing figures because they are not as desired, topping up forecasts with a 'hope' margin, or rationalising recurring poor performance as being caused by glitches is a dangerous game. It is certainly important to set a positive mood for the business, however, it is important, at least at the board level, to be prepared to admit and tackle the issues underlying poor cash flow performance.

"Big problems always surface. If they have been hidden, even unintentionally, the negative fallout is always worse." ("How to become CEO" by Jeffrey J. Fox)

Once the underlying issues are understood, it is important that they are addressed. When you are constantly distracted by a barrage of new issues, it is easy to procrastinate. Instead you should prioritise and address the most important issues.

If a potential cash flow problem is identified early enough, the priority can be to get the business operations back on track. Your time should be spent agreeing, communicating and implementing the changes required. However, if the situation has reached cash crisis point, then you need to roll up your sleeves and get involved in detailed cash management. This may include the following: allocating responsibility for following up debts, managing and providing reassurance to your creditors and proposing realistic new payment dates.

Taking a proactive approach with your creditors will save future time and disruption. Most importantly you should agree a daily cash plan for your recovery and micro-manage it, following up on all variances until the position stabilises. You can then focus your attention on the longer term changes required to ensure business sustainability.

The key to avoiding business critical cash flow problems is to recognise problems early and to take appropriate action. Tweaking a business here and there will probably not produce the necessary results and a delay in significant actions can often increase the adverse business impact.

In conclusion, ensure the following are well understood within your business:

- Profit and cash are different.
- Cash forecasts must be realistic.
- Cash forecasts must be prepared on a regular basis.
- Cash variances should be investigated.
- Customer, product and service profitability.
- The option to terminate customers or pet projects.
- Straying from your core business can be expensive.
- Admit when the business has a problem.
- Address problems early and appropriately.