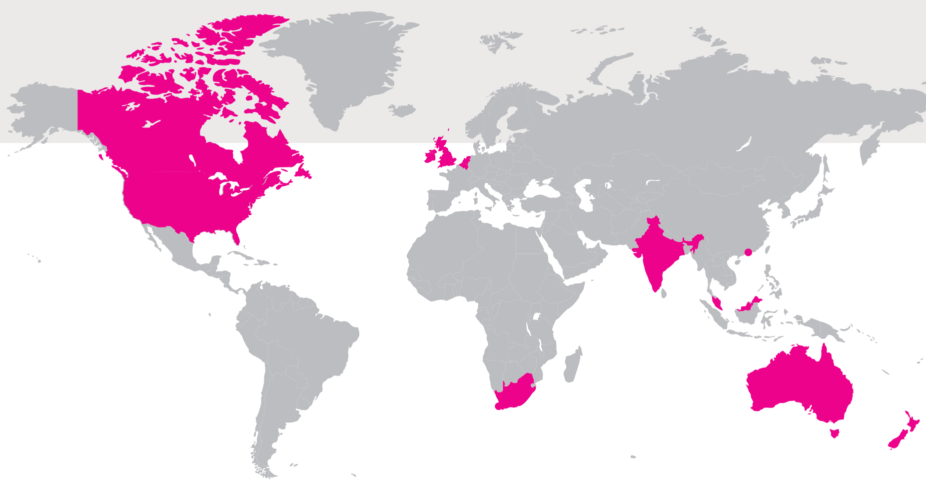
the cfo centre

STOP WORRYING ABOUT CASH!



Cash flow

“We had a significant cash flow problem last year and our CFO was able to calm our nerves and get us back on the right track”

Dave Knight, Igence

Executive summary

Poor cash flow management can cause huge problems for even the most profitable businesses. Until you find and fix the cause of cash flow problems in your business then put systems in place for managing it, your company is at a very grave risk of failure.

For the stark truth is without cash, your business will be unable to meet its payroll obligations, be more likely to default on payments to suppliers and creditors, and in the worst case, be forced to cease trading.

Without well-defined and well-managed strategies to avoid running into cash flow problems and a plan to improve cash flow if such problems should arise, many companies will flounder, yours included.

Highlights

- The main cause of cash flow problems in any business
- How a part-time CFO can help you to avoid or resolve your cash flow problems and prevent them from recurring

Introduction

It doesn't matter if your product or service is outstanding, your market share is bigger than your competitors', your team is highly productive or if you have a steady stream of new clients, your company is at risk of going under if you don't have a firm grip on your cash flow.

You might think you're immune from danger because your business is experiencing a high level of growth, but you're wrong: expansion can exacerbate the problems caused by poor cash flow management.

Cash really is the oxygen on which every business depends. Without a steady supply of it, your business cannot survive.

That applies even if your company is profitable. Business consultant Bill McGuiness says, "The sad fact is that the majority of failing firms are profitable as they enter bankruptcy."[1]

Without clearly defined and well-managed strategies to avoid running into cash flow problems and a plan to improve cash flow if such problems should arise, many companies will flounder, yours included.

Cash flow management is not a short-term fix to a problem but should be part of the fabric of the business.

[1] *'Cash Rules: Learn and Manage the 7 Cash flow Drivers for Your Company Success'*, McGuiness, Bill, The Kiplinger Washington Editors, Inc., 2000

It is like an internal insurance policy for your business. Getting to grips with your income and expenditure and understanding where you stand today as well as in the months and years ahead gives you and the rest of your senior team a great sense of clarity and peace of mind.

It also makes it easier for you and your team to plan and make decisions.

For that to happen, you need to analyse and then manage the flow of cash in and out of your company on a weekly, monthly, and annual basis. You also need to create a cash flow forecast for at least three months ahead so you and your senior team are aware of when cash shortfalls are likely to occur. This will allow you to cover your working capital requirements.

This way you keep your company healthy and resilient.

The main reasons for cash flow problems

Essentially, your cash flow problems are likely to be the result of one or more of the following:

Slow-paying customers

The overall level of late payment owed to small and medium-sized businesses in the UK is £32.4 billion, according to a report by Bacs Payment Schemes Ltd (Bacs).[2] Of the companies surveyed, 59% say they are impacted negatively by late payments.

The average late payment burden shouldered by SMEs now stands at £31,901. This puts many SMEs perilously close to bankruptcy with £50,000 being the maximum that SMEs in the survey say they could bear before going to the wall.

More worryingly, 25% SMEs state that £20,000 or less is enough to jeopardise their business prospects.

More than three quarters (76%) are being forced to wait at least a month beyond their agreed contract terms before getting paid.

The knock-on effect of this is that business owners have to make tough decisions to make it through the month. Some 20% of directors in companies that experience late payments say they have taken a cut in salary in order to keep cash inside their businesses.

Over a quarter (26%) use their overdrafts to make ends meet and one in 10 are experiencing one or more of the following challenges every month:

- Difficulties in paying staff on time
- Factoring invoices
- Difficulties paying regular bills.

Some 23% claim the late payment situation is forcing them to pay their own suppliers late.

Poor collection from debtors

Many companies don't issue invoices quickly enough. They're even worse when it comes to chasing up invoices.

If this is the case in your company, it's important to realise that every sale has already cost your business something in terms of labour, purchase of raw material, warehousing, advertising, etc. If you don't collect what you're owed, you'll be worse off than if you never made the sale. American entrepreneur Nolan Bushnell is fond of saying that a sale is a gift to the customer until the money is in the bank.[3]

Your fixed costs are too high

If it is to survive, your business needs to bring in more cash than it spends. If it doesn't, its long-term survival is unlikely. Three of your biggest fixed costs (expenses) are likely to be payroll, capital expenditure (equipment, hardware, and plant) and office costs.

Your prices are too low

It's quite common for businesses to set their pricing levels at the low end of the market in a bid to win customers. If their expenses rise, their profit margins get smaller. Unfortunately, if they raise their prices, they risk alienating customers who have become accustomed to the low prices.

[2] *'Late payments are forcing businesses to make tough decisions'*, Bacs, www.bacsservices.co.uk, Feb 16, 2015

[3] *'Finance for the Non-Finance manager'*, Siciliano, Gene, McGraw-Hill Companies, Inc, 2003

Your sales are too low

The way many business owners tackle the problem of low sales is to look for new clients. That inevitably incurs more costs since it involves spending more on advertising and marketing to attract those new clients.

There are other more cost-effective ways of boosting sales. They involve encouraging your existing or dormant customers to spend more and to do so more often.

You're giving customers too generous payment terms

If your payment terms are overly generous (say, 60 or 90 days rather than 30), you could find that your business is constantly having to make up the cash shortfall.

Allowing customers to pay in arrears for goods or services received is similar to offering those companies short-term unsecured loans, says financial advisor John Toppin, MA FCA.[4]

"This form of financing is a fabulous deal for the customer as it is commonly unsecured, interest-free and the customer can pay its debt well beyond the agreed credit terms if it likes," he says.

"What is more, unlike bank lending, the customer rarely has to pass any form of credit check to obtain these generous and virtually unlimited credit facilities."

An accumulation of old stock can tie up your cash reserves and prevent you from buying more up-to-date stock

You're overtrading

This happens when your business experiences rapid growth (which forces you to invest in more stock, equipment, buildings, staff, etc.) but you don't have the working capital to match that growth.

You have too many bad debts

Even a couple of bad debts may be enough to put your own business in jeopardy. That's why it's best not to rely too heavily on one or two big clients.

You're holding too much old stock

An accumulation of old stock can tie up your cash reserves and prevent you from buying more up-to-date stock. If this is the case, you should look for ways to sell off as much of that stock as quickly as possible.

[4] *'Cash Flow: Advice For Business Owners And Finance Managers'* Toppin MA FCA, John, Nomizon Business Publishing, Kindle edition, Sep 30, 2014-09-30

How a part-time CFO can help you to resolve your cash flow problems

The CFO Centre will provide you with a highly experienced senior CFO with 'big business experience' for a fraction of the cost of a full-time CFO. This means you will have:

- One of Australia's leading CFOs, working with you on a part-time basis
- A local support team of the highest calibre CFOs
- A national and international collaborative team of the top CFOs sharing best practice (the power of hundreds)
- Access to our national and international network of clients and partners

With all that support and expertise at your fingertips, you will achieve better results, faster. It means you'll have more confidence and clarity when it comes to decision-making. After all, you'll have access to expert help and advice whenever you need it.

In particular, your part-time CFO will assess your company's cash flow position and take the following steps:

Identify all the immediate threats to your business

A part-time CFO will look for all those things that could plunge your company into serious financial trouble if they're not addressed immediately.

These could be factors such as the payment of wages or salaries, the payment of GST or the payment on a due date for vital goods, etc.

Address those imminent threats

Your CFO will look for ways you can meet your most pressing financial requirements and buy the company more time. This might involve:

- Chasing late paying customers. To encourage those customers to pay, consider offering a discount for immediate payment or asking them to pay immediately by credit card.

- Hiring a company that provides invoice financing (either invoice discounting or factoring) so you receive an immediate cash injection. Such companies provide funding against your unpaid invoices for a fee. With invoice discounting and factoring, you'll receive up to 85% of the value of the outstanding invoice, sometimes within 24 hours. You'll receive the remaining 15% minus a fee once your customer has paid the outstanding invoice.

An invoice discounting service can be confidential so that your customer will be unaware of the financier's involvement. Factoring companies however undertake a full collection service (including sending out statements, making reminder calls and collecting payment), so your customers will be aware that you're using their services.

- Arranging short-term loans or overdraft facilities with your bank
- Considering other funding sources besides banks and other lending institutions such as self-finance, or loans from family and friends, partners, investors and alternative finance like peer– to–peer lending.
- Asking for better terms from creditors. You may find they're open to extending your repayment schedule.
- Identifying and addressing the underlying problem Assess the business to identify the cause of the cash flow problems. Address those issues to avoid a similar situation occurring again.

Prevent cash flow problems from recurring

As well as identifying and resolving the imminent threats to your business, your CFO will review all incomings and outgoings to determine where improvements and savings can be made. This is likely to involve:

- Working out your break-even sales figure (the amount of sales required to cover total expenses without making a net profit).
- This will mean reviewing your sales figures for the past six months to check that you exceeded that breakeven point. It's then possible to calculate how much you're likely to make in sales for the next two months. If you're unlikely to break even, you'll need to plan how to increase sales and reduce costs.
- Downgrading your drawings from the business until your revenue improves.
- Looking for ways to increase your profit margins such as raising prices. You can do this without losing valuable customers by offering packages or bundles of goods or services.
- Cutting costs. The beauty of cost-cutting is that it can be done in hours or days, unlike revenue-boosting measures which take longer to implement and to take effect. Such cost-cutting measures might include doing any of the following:

- Stopping work on non-critical capital projects.
- Reviewing your stock and selling off obsolete, damaged, or discontinued products.
- Eliminating slow-moving products or less popular services from your line since selling unprofitable goods or services is likely to send you out of business faster.
- Negotiating price discounts for volume purchases from your suppliers.
- Considering downsizing. Bigger is not better if your company is always struggling to stay afloat. If your profit margins are consistently small, reassess your business goals. Rather than expansion focus instead on profit.
- Ditching products or services with the lowest profit margins. This change of focus may mean you can also reduce the size of your borrowings, staff, advertising, and marketing campaigns, premises, etc.
- Reducing labour costs (without triggering a drop in productivity). Any cost-cutting measure that triggers a drop in staff morale will have negative consequences for productivity. Your CFO may advise you to defer salary increases and bonuses or to cut salaries from the top-down. You might also consider introducing a temporary freeze on overtime. Other measures might include lowering the number of employees through attrition or redundancies.

- Speeding up the sales process. Your CFO will encourage you to accelerate the speed with which your customers' purchase orders are converted into cash. In particular, you'll be asked to consider what steps in the sales process can be combined or eliminated. For example, asking for payment at the time of the order, accepting credit card payments, or offering automatic account debiting.
- Lowering miscellaneous expenses. You'll be encouraged to find ways to make small savings on things like insurance policies, office rent, bank service charges, utilities, etc. Lots of small savings across the board can have a significant impact.
- Refinancing your debt obligations. Your CFO might suggest approaching your lenders to see if you can lower your monthly payments on your term debt obligations by taking the remaining principal amount and spreading it out over a longer period.
- Analysing if you can outsource jobs or services. You'll be asked to look at your operations to determine if any of your activities, services, or functions could be provided at less cost by an outside company or contractor.
- Holding a sale of surplus or slow-moving stock.
- Approaching suppliers to negotiate better deals.
- Asking your suppliers to take back excess stock.
- Selling off your underused assets and renting the equipment instead.[5]

"With all that support and expertise at your fingertips, you will achieve better results, faster. It means you'll have more confidence and clarity when it comes to decision-making.

[5] '*How to manage a cash crisis*', NAB (National Australia Bank) Ltd., 2011

Improving credit control. Your CFO will help you to get tighter controls over your credit. That will mean:

- Getting written agreement to your credit terms before taking on new clients.
- Many businesses are not clear about credit terms with their clients and often simply set out conditions on the face of the invoice, but that's too late in the process. Instead, you should always ensure that an authorised representative of your customer has agreed to your credit terms in writing before you agree to supply products or services.
- Carrying out credit checks on all new customers, no matter how large or influential they may appear.
- Invoicing at the time of a sale or close to it. Instead of waiting for the month's end to issue invoices do it daily or weekly.
- Making sure your sales invoices are accurate. Unfortunately, some customers will use any excuse for not paying invoices on time and any inaccuracies (such as an incorrect address or date or no purchase order number) could be enough for them to justify delaying payment.
- Treating the collection of monies owed as a high priority. If you haven't already done so, set up a computerised system to provide notification of late payments.
- Setting up an invoice dispute resolution process. It's important that your company records any documentation related to invoice-related disputes. You should also keep a record of those customers who challenge their invoices or raise questions so it's possible to see if any do this regularly as a way of avoiding settling their accounts.[6]

[6] *'Top Tips for Enhancing Your Invoicing Process - and Avoiding Problems with Your Business Cashflow'*, Finlay, Mitch, Talk Business magazine, www.talkbusiness.co.uk, Jan 2015

Your CFO will encourage you to use regular cash flow forecasts so you know how much cash is going to be needed in the coming months.

Instigate the use of regular cash flow forecasts

Your CFO will instigate the use of regular cash flow forecasts so you know how much cash is going to be needed in the coming months. It means you'll know in advance if you're likely to face a cash shortfall and can make arrangements for extra borrowing, or take other appropriate action.

It will also make it easier for you and your senior team to make decisions such as whether or not to:

- Hire more staff
- Change your prices
- Move premises
- Tender for a large contract
- Find new suppliers.

You'll be able to see at a glance the impact such decisions might have on your cash flow.

Cash flow forecasts can also highlight potential problems so that you have time to take action to avoid them.

Conclusion

Your cash flow keeps your business alive. Having control of your company's cash flow which allows you to operate within your means, and move away from a 'feast and famine' situation is usually a huge relief to everyone within the business.

It means that decisions can be made and checked against the cash flow forecast to determine whether they are viable. This increased visibility can be introduced quickly and can have a hugely positive impact on the whole business.

It also means that reserves can be built up gradually to give the business a cushion and alleviate the stress of not knowing what lies around the next corner. Having the right cash flow management processes in place and being able to spot peaks and troughs in trading to improve cash flow is one of the most critical components of any finance function.

Put an end to your cash flow problems now by calling the CFO Centre today.

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