Taking Control of Your Cash Flow

A Financial Management Guide for Entrepreneurs

1

Understand
your cash flow

Cash flow is the money that moves (flows) in and out of your business over a specified period of time. Good cash flow management requires that you understand how cash moves through your business over time.

2

Track
your cash flow

You can forecast your cash flow based on an understanding of the flow of sales, receivables, inventory and payables. Your forecast is a tool to help you plan and build cash reserves to handle emergencies. Regularly updating your forecast will allow you to anticipate potential problems and act quickly.

3

Improve
your cash flow

Cash flow management is all about understanding where your money is “stuck” and how to get it into your bank account faster. Any tactic you can come up with to encourage clients to pay sooner, or to make your collection process more effective, will improve your access to cash.

What is cash flow?

Cash is an essential resource that allows you to perform activities and make transactions that keep your business going.

The lifeblood of your business

There are times when you have lots of cash, for example, after you receive money from a big sale. There are other times when you do not have a lot, for example, after a big purchase.

Even a profitable, fast-growing company can face a serious cash flow crunch while waiting for money to come in. In fact, it's surprisingly common for profitable companies to go out of business because they ran out of cash. That's because cash flow is different from revenue and profit.

Revenue

Revenue is recorded when you invoice your customer for your products or services. But earning high revenues does not mean you have enough cash to pay money you owe your suppliers because you are still waiting for your customers to pay their invoices.

Profit

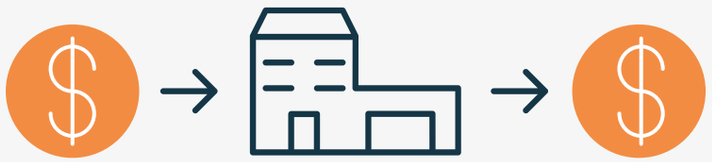
Profit is what you have left after you have subtracted all of your expenses from the revenue you have recorded. If your business isn't consistently profitable, better cash flow management—while helpful—will be no better than a Band- Aid on a potentially fatal wound.

Cash flow

Cash flow refers to the money you collect and use to purchase inventory and pay suppliers. It represents the amount of money that actually comes into and moves out of the business within a specific period of time.

How much cash is going in and out of my business?

Your cash flow is made up of the cash coming into and leaving your company over a given period. It measures how much cash your company takes in versus how much it spends.



Cash inflow

Any cash coming into your company is a cash inflow.

If your customer has purchased your product or service on credit, it is a cash inflow, but this cash will come in at a later date.

Cash outflow

Any cash leaving your company is a cash outflow.

If you buy items on credit, it is a cash outflow, but it will occur at a later date.

3 key elements of your cash flow

Accounts receivable (i.e., cash inflow)
The money customers owe your company for goods or services they have received but have not yet paid for.

Accounts payable (i.e., cash outflow)
The money a company owes its suppliers for goods and services that have been provided but not yet paid for.

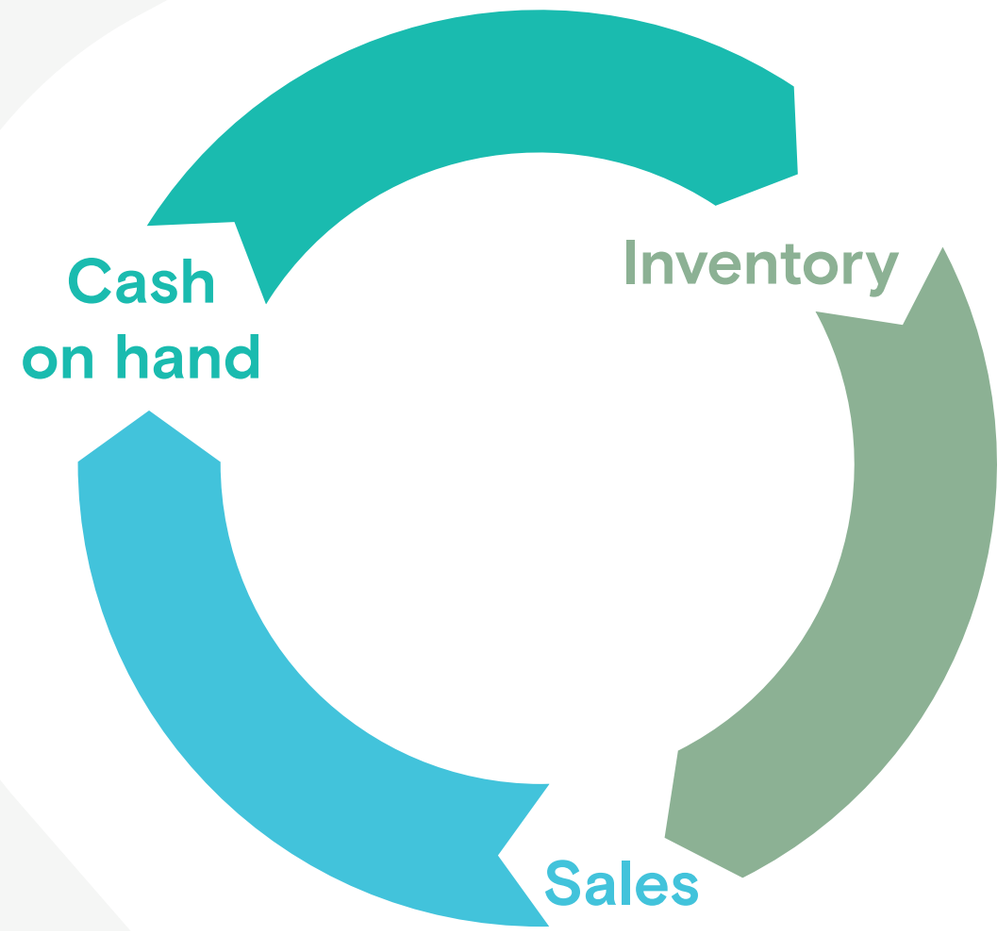
Inventory
The raw materials and finished goods that are purchased from suppliers and then sold to customers to generate revenue. When you buy inventory on credit, it creates accounts payable. When you sell it on credit, it creates accounts receivable.

Cash conversion cycle: An essential tool to boost your cash flow

The cash conversion cycle measures how fast your company can convert its cash on hand into inventory, and then convert inventory back into cash. Figuring out how long this cycle takes allows you to understand how many days your company's cash will be tied up, making it unavailable for use in the business.

The shorter your cash conversion cycle is, the better, because shorter cycles mean cash is moving faster through your business. The faster you sell your inventory, the lower your average days inventory is, so make sure you don't over-order or let it collect dust from holding it too long!

The quicker you collect your accounts receivable, the lower your average days receivable and the sooner you have access to this cash to use in your business. The longer your average days payable, the more your suppliers are helping you finance your business, which is helpful, but don't push them too hard!



Calculate your conversion cycle

Average days inventory + Average days receivable − Average days payable = Cash conversion cycle

What does a positive cash conversion cycle mean?

It means slow cash flow

A positive number means that your daily operations are tying up cash. You may need to get extra financing to support the business and be able to pay your suppliers on time

What does a negative cash conversion cycle mean?

It means quick cash flow

A negative number means your day-to-day operations are moving cash quickly through the business and you will not have any problem paying supplier invoices. The greater the negative number, the easier it is to pay suppliers and meet your financial obligations.

Tracking my cash

One of the easiest ways to keep track of your cash is by using a cash flow planner—a simple spreadsheet that shows all the expected money inflows and outflows for your business. This tool can be used to forecast and estimate changes to cash flow. Your ability to track your cash flow depends on your ability to monitor expenses, manage receivables and payables, and plan your activities.

Cash flow planner example

	Week 1	Week 2	Week 3
Opening cash balance	10,000	9,000	12,000
Total cash inflows	2,000	5,000	2,500
Cash sales	1,500	1,500	1,500
Accounts receivable	500	1,000	1,000
Other	0	2,500	0
Total cash outflows	3,000	2,000	4,000
Rent	800	800	800
Payroll	1,000	0	1,000
Accounts payable	1,800	1,000	2,000
Insurance and utilities	200	200	200
Cash forecast	9,000	12,000	10,500
Net change in cash	(1,000)	3,000	(1,500)

How much cash is in your business at the beginning of a given period. This number is the same as the closing balance from the previous period.

Cash that flows into your business from general business activities, as well as from grants and sponsorships.

Cash that flows out of your business during usual, predicted and unexpected operational activities.

It displays cash available to you at the end of the current period.

My annual financial planning

At the start of a new year, you should take stock of your business strategy and identify your expenses.

Answering these questions is a critical part of your company's annual financial planning. Once you have a clearer view of your situation, create a cash flow budget to see if you have enough cash available to implement your strategy. If you don't, then you need to find ways to improve your cash flow.

Do I need **to expand?**

Do I need other **new resources?**

Do I need **more equipment?**

How will my plan affect **my cash flow?**

Do I need to hire **more staff?**

Will I need **financing?** If yes, how much?

Learn more

5 key steps to plan your cash flow in the coming year

Get paid faster!

Your business can get into a situation where your sales have grown, but your bank account balance hasn't. While there can be many reasons for this, the way you collect your accounts receivables is especially important.

Effectively collect outstanding bills

Send the invoice

Make sure you have sent the invoice to the correct person for payment. Send the invoice immediately after the product sale or service is rendered.

Establish a reminder system

Define how many times, when and in what form you will contact late payers. Is it a reminder email or a phone call? Will it be once a week or more often?

Send the invoice again

Resend an invoice to a customer to make sure it was not lost or forgotten.

Talk to your customer

If late payment goes on too long get on the phone and talk to your customer firmly.

4 tips to collect money quicker

1

Get invoices out faster

The earlier you invoice, the sooner you get paid. Be sure to send invoices as soon as you ship or complete a job, preferably by email.

- Make sure you send them to the correct person.
- If you're working on a large job, consider negotiating upfront deposits and progress payments.

You also should consider using mobile technologies to collect faster. This can cut down on mailing and paper costs.

2

Offer discounts to encourage faster payment

You can consider offering a small discount for quick payment. For example, a discount of 2% if paid within 10 days is common. But these discounts are costly and should be used only if you need to get cash in the door very quickly.

3

Ask for early payment

In extreme cases, and only if you have a good relationship with your customer, you can ask for an early payment. This is another good reason to have good communication with your customers!

4

Identify barriers to change:

Consider setting your business up to accept credit card and e-Transfer payments from slow payers to speed up the payment process. In addition, you can consider delaying additional work to slow payers until their outstanding invoices are paid.

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