HOW TO MANAGE YOUR CASH-FLOW WHEN MONEY IS TIGHT

The Sustainable CFO

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A simple five step process to prepare a cash-flow projection

Cash is the "blood" that flows through a business. Without cash a business will die – *no cash equals no business*.

Unfortunately, the lack of cash is very common in business. It's not a matter of if it will happen, but when. You certainly won't like it but it certainly does not have to be a disaster. You can't always prevent a cash-flow problem from occurring, but if you know when it is coming you have time to address the situation.

If you are at a point where you are afraid of what you will find if you complete a cash projection, then you absolutely need to do one now!

Here is an easy to follow, *5 step process* to help you take control of you cash, get rid of the nasty surprises, and be confident that you can pay your bills!

STEP 1 - UNDERSTANDING CASH-FLOW

It may sound simple but the first step in managing cash-flow is understanding what cash-flow really is. In basic terms it is the difference between cash coming in and cash going out.

The real key however is timing - *when* cash is coming in versus *when* cash is being spent. It would be nice if cash-flow was like a tidal flow – coming and going on an even and predictable schedule. Unfortunately cash-flow is a little more complicated since it involves many more pieces.

Accountants define the cash-flow cycle as: the time between buying raw materials, converting them into inventory, selling your inventory, and finally collecting on those sales. The lag time between each of those steps is what can cause an issue. The longer it takes to convert cash out into cash in, the more chance there is for a shortfall. In a recession, the cash-flow cycle is long and getting longer.

Understanding your particular cash-flow situation has become absolutely critical to your business survival. For your business to survive you have to make the commitment to do what it takes to never run out of cash.

So make the commitment now and move on to *Step 2: KNOWING YOUR CASH BALANCE!*

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STEP 2 -KNOWING YOUR CASH BALANCE

Do you know your cash balance today? How do you know where you are going if you don't know where you are starting from?

The smartest business people will still make bad decisions if they have no information. Make it a priority to know your cash balance - it should be as familiar to you as your social security number!

Now don't say, "That's easy. I'll just call the bank." Your cash balance is not what the bank says you have. The bank only knows about the transactions they have seen. They don't know about all the checks you have written that haven't been cashed yet.

You need to know your adjusted checkbook balance. This means keeping your checkbook register up-to-date, not once a week, but every day. A lot can happen in one week.

Without the correct information you can make too many bad decisions – promises that you can't keep, or worse yet write checks that will not clear. There is no quicker way to ruin your reputation than by bouncing checks.

So finish Step 2 and figure out what your *real* cash balance is today!

STEP 3 – GATHER THE INFORMATION

To prepare you cash-flow projection you need to know where it is coming from and where it is going to. You do not need a crystal ball but you will need to do some educated guessing. The more thorough and realistic you are the better prepared you will be.

Estimating when you will be spending cash is relatively easy since it is starts with the bills you already have on hand. To figure out when you will be spending cash you need to look at an Accounts Payable Aging Report - a list of all the bills you owe and (most importantly) when. If you enter your bills into your accounting system when you receive them, then you should be able to produce a report very easily. For example, in Quickbooks the report is titled, "Unpaid Bills Detail." It is important to note that for the report to have any value you must enter the bills with the *correct due date*.

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You also need to consider spending that you don't have a bill for – payroll, quarterly taxes, and equipment maintenance. Get in a "worse case scenario mindset" - include every expenditure that "might" happen.

The most common cause of cash-flow problems is being confronted by an expense you didn't plan for. You can expect the best, but you need to plan for the worst and then be happy if it doesn't happen!

Estimating cash coming in requires a bit more guessing, judgment, and conservatism. You judgments need to be based in reality, not on what you would like them to be. If you send bills to your customers, you can base it on when your customer's invoices are due but bear in mind their individual payment history. Just because you send a bill to a customer that says it is due in 30 days doesn't mean every customer will pay in 30 days. If you have customers that always pay 15 days late, then you have to assume they will continue paying 15 days late, and adjust the date you expect to be able to make a deposit.

You need to be honest and realistic when guessing about cash coming in – the worst thing you can do is fool yourself into believing that there is more cash coming in than there really is.

Now that you have you best and most conservative estimates of when your bills that are due and when you will be making cash deposits, you are ready for *Step 4 Creating a Cash-flow Projection!*

STEP 4 – CREATE A CASH-FLOW PROJECTION

Good news! A cash-flow projection is really not as complicated as most people think! Preparation does not take sophisticated software or a staff of accountants. A cash-flow projection is very similar to a checkbook.

Your checkbook is a record of *historical* cash transactions. A cash-flow projection is a record of *future* cash transactions. A cash-flow projection starts with where you are today, adds what cash you expect to collect, then subtracts the bills you expect to pay. The result is the cash you expect to have at the end of the period.

The cash-flow projection is usually prepared on a monthly basis but can be prepared weekly. When cash is tight, I recommend a weekly format as shown in Table 1.

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Table 1

	12/05/11	12/12/2011	12/19/2011	12/26/2011
Beginning Cash Balance	$89,452.97	$98,300.20	$91,699.81	$103,760.23
Expected Cash Deposits	75,000.00	32,852.55	40,671.19	36,274.89
Bills to Pay	(66,152.77)	(39,452.94)	(28,610.77)	(136,149.77)
Estimated Ending Cash Balance	$98,300.20	$91,699.81	$103,760.23	$3,885.35

In Step 3, you collected the information on your bills. In your Cash-Flow Projection organize your bills by week based on the actual invoice due date (not how late you think you can pay a bill, but when it is really due!)

It is more conservative to plan on paying bills when they are *actually due*. If you have the cash it is better to stay current with your vendors. If you schedule a bill to be paid two weeks after it is due and then you can't make the payment you are already a week behind and you might find your vendor changing you to COD terms!

In Step 3, you also gave some thought to your cash coming in. In your Cash-Flow Projection enter your weekly *expected* cash receipts. With cash receipts, it is more conservative to estimate your deposits being made later rather than sooner.

It is better to be pleasantly surprised by cash coming in early, than to be disappointed and unable to pay your bills because the cash came in a week too late.

It's great that you have prepared a schedule, but now it's time to put it to good use! On the *Step 5 Analyzing Your Projection!*

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STEP 5 – ANALYZE YOUR PROJECTION

Now that you have taken the time and effort to create a Cash-flow Projection, you have to use it.

Start by looking at the *Estimated Ending Cash Balance*. Where does your cash start to get tight? Is there a time when your balance goes negative – where you don't have enough cash?

Table 1 is an example to show you a simple but useful format. It shows a weekly projection for 4 weeks. The cash balance started at $89,452.97 but by the week ending July 28, 2008 the cash balance has gone down to $3,885.35. This may be a problem.

When cash-flow is tight I recommend doing a weekly projection for 8 weeks. It's better to have extra time to be able to address a potential cash shortfall.

After a month, you will also want to compare your Cash-flow Projection to your actual checkbook results. How did your guesses compare with reality? What did you over or under-estimate? Use these differences to adjust and improve your guesses going forward.

Your Cash-flow Projection is like a blood pressure cuff for the lifeblood of your business. But just like a one-time blood pressure reading doesn't tell you much, a Cash-flow Projection done once won't give you much information either. To give you the best information in the timeliest manner, your Cash-flow Projection should be updated weekly.

You can't always prevent a cash shortfall but if you make the commitment now to prepare a projection and keep it updated, you will never be unpleasantly surprised by a cash crunch.

Forewarned is forearmed. So make your Cash-flow Projection a top priority for your business!

If you would like help preparing and analyzing a cash-flow projection, or smoothing out the highs and lows, contact *The Sustainable CFO*, we have simple and practical solutions to improve your cash-flow problems and keep your business alive and thriving!

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