

The Small Business Guide To Cash Flow Management

Cash flow is the life-blood of every business. For a small business, cash flow can make or break its ability to survive. Owners of successful small companies know how to use cash flow management processes and strategies. Those who don't are almost always certain to fail.

The Basics of Cash Flow

Goal: Cash-in exceeds cash-out.

Business owners use cash flow management to monitor, analyze, and make adjustments to their company's cash flow. Cash pays salaries and vendors, maintains inventory, and covers operating costs.

For any small business, the most important aspect of cash flow management is avoiding extended cash shortages caused by a significant gap between cash inflows and outflows. At the most basic level, it means converting sales into cash as quickly as possible while reducing and extending your payments as long as possible. If you can't pay your bills over time, you won't be able to stay in business.

The Well-Balanced Cash Flow

Cash Flow Analysis and Projection

A cash flow analysis, or forecast, performed on a regular (usually monthly) basis will demonstrate if the income generated by sales produces sufficient cash to pay for obligations. This information clearly reveals a positive cash flow (net gain) or a negative cash flow (net loss).

Monthly cash flow projections compare previous projections with actual figures. Over time, principal changes will become apparent. Many software accounting programs have features that simplify cash flow analysis. A professional accountant can create a cash flow analysis tool that is unique to your business.

4 Strategies for Closing The Cash Flow Gap

A common problem for small businesses is the cash flow gap, which is the lag time between payments due to suppliers and payments collected from customers. The combination of low inventory and cash shortage creates a gap that, unresolved, risks future sales.

How do you close this cash flow gap and stay in business? Here are some strategies for small business owners:

Avoid surprises. Monitor the cash flow closely.

A good forecasting tool will allow you to detect potential cash flow problems and take appropriate steps to mitigate them. Pay particular attention to inventory levels and sales volumes.

Maintain healthy credit options.

A revolving credit line from a bank can solve short-term cash flow problems. Establish a relationship with your lenders early on, before you actually need financing.

Shorten your cash flow conversion period.

To speed up the time it takes to generate income and to increase your cash reserves:

- **Invoice customers immediately** upon delivery of your goods or services. Whenever possible, ask for payment on delivery (COD). Avoid monthly invoicing which can add as much as 30 days to the cash flow conversion period.
- **Provide services on monthly retainer** or by annual contract, with an agreement for pre-payment at the beginning of every period. It is becoming increasingly common to charge and collect fixed monthly recurring rates, annually.
- **Today there are many online tools and services/apps** available to make bill paying easy for your customers. Learn what they are so that you can offer valuable suggestions, or tools, to your customers.
- **Offer customers an early payment discount.** Offer a small discount to customers who pay early, before the usual payment due date.
- **Require deposits for special orders.** If you sell custom products, or take a special order from a customer, charge a security deposit of 50%. You may also want to charge a cancellation or re-stocking fee. If so, you'll need to make these terms clear at the point of sale.
- **Manage payments to vendors.** Avoid making early payments to vendors. Remember, you want to keep the cash in your accounts as long as possible. If your contract allows, your regular pay cycle can be stretched to as much as 45 or 60 days without penalty. Like you, your vendors want regular payments.
- **Take advantage of the market.** Many small businesses price their products lower than the market and do not make a profit. Research and monitor the market for your products or services, distribution costs, and competition. Pricing yourself too low may do you more harm than good in the long run.
- **Control accounts receivable.** Profits are lost when a company is not aggressive with collection. Tracking your past-due accounts and actively pursuing collections is required. Establish and publicize a clear policy and process for following up with late or delinquent payers. Accounting software programs are efficient tools to support the company's collection process.

What I Learned About Cash From My Small Business

- ✚ Know how much you need each month to keep your business open. That amount is your bottom line, your "break even," or, your "burn rate." Keep this number low and always in your mind.
- ✚ Don't count on timely payments. Maintain a cash reserve buffer to carry you through the waiting period. That's what it's for.
- ✚ If you have to take out a loan, do it face-to-face. The relationship you develop with your loan officer will certainly be important again in the future.
- ✚ As you build your business, do everything you can to stretch out your money. Hold on to your cash and make purchases on terms whenever it makes sense.
- ✚ Never lose track of how much cash you have in your account. Your balance and your "burn rate" are quick and basic measures of your business's health. Pay attention.

Reduce your costs.

Consider barter or trade arrangements with other business owners or customers. Trade your products for services.

Buy, maintain and repair used equipment whenever possible. If well maintained, used or refurbished equipment is often as good as new. You may be able to barter a service agreement with a local technician.

Small business owners can use many strategies for maintaining adequate cash reserves. Bottom line? Try to have enough to pay normal operating costs for at least three months. Six months is better.

Charles P Myrick CPA is a tax preparation firm providing accounting and bookkeeping services to clients throughout the Washington, District of Columbia area. We provide our small business clients with cash flow and budgeting analysis systems that help analyze spending, and re-balance budgets and/or debts for an optimal cash flow. Feel free to contact us at any time.