PROACTIVE CASH FLOW STRATEGIES FOR BUSINESS OWNERS

LEARN THE CASH FLOW STRATEGIES YOU NEED TO GET THROUGH ALL ECONOMIC CYCLES

MCP FINANCIAL SERVICES

Table of Contents

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Understanding Your Cash Flow

Meeting the Cash Flow Challenge

Cash management can be challenging, even in the strongest economic times. In tougher economic cycles, cash flow is often harder to navigate and can shine a light on deeper issues that need attention in a business.

This guide aims to help you understand cash flow drivers and offers strategies to help you grow your business the right way.

Understanding Your Cash Flow

Four Drivers of Cash Health

01

Working Capital Management

Working Capital (WC) is the lifeblood of business. In simplistic terms, WC is defined as Current Assets minus Current Liabilities. Poor working capital management has caused business failures, even when the financials show a profit.

Business owners often sacrifice salaries or dividends to manage a working capital cash shortfall, hoping that 'things will turn around'.

Current Assets - Current Liabilities = **Working Capital**

02

Operating Performance (The P&L)

No amount of efficient WC can be a substitute for a good revenue model, sufficient gross profit and effective cost management. Your business model and profitability are the foundation of a sustainable business. A business needs profits that convert to cash.

03

Growth Pains

When your business grows, it sees increased sales, more inventory purchases, and more considerable debtor amounts to collect. This growth may lead to increased profits and a higher need for additional working capital.

In other words, growth is a good problem, but the business needs consistent cash flow for the growth to be sustainable.

04

Under-Capitalised

Many businesses are structured poorly from a capital and funding perspective. Business owners must be realistic about how much capital or dividends they remove from a business or contribute to it. Debt and Equity are very different. Each has unique characteristics that must be understood and managed mindfully for long-term success.

Four Factors that affect Cash Flow

01 Your Permanent Working Capital

Most businesses require a minimum level of WC. Inventory (or services) must be purchased before being sold, and money needs to be collected after it is invoiced. All the while, the operating costs of the business (wages, rent, etc.) continue to accrue.

Managing cash in and cash out (cash flow) is made easier by retaining a permanent amount of working capital in your business. In other words, the amount you need to keep on hand to effectively operate your business.

What is Normal Working Capital?

Knowing what is normal begins with understanding the average cash cycle. For example, a business might have an average cycle of:

60 days to turn Inventory into Sales (Invoices)

45 days to collect Invoices

30 days to pay Suppliers

This cycle is known as **Working Capital Days.**

HOW TO FIND NORMAL WC DAYS

WC Days for an Inventory Business

Using the above example, Working Capital Days are easily translated as shown below.

If this cycle is constant, the WC Days are:

Inventory	Debtors	Creditors	
60 days	+45 days	-30 days	= 75 Days

Let's translate this into numbers.

Inventory	Debtors	Creditors	
$150,000	+$250,000	-$100,000	= $300,000

If this is a "normal" position based on the size of the business, then the cash needed permanently on hand is **$300,000.**

WC Days for a Point of Sale Business

Say a business collects cash at the point of sale and has 60-day supplier terms.

If this cycle is constant, the WC Days are:

Inventory	Debtors	Creditors	
60 days	+0 days	-60 days	= 0 Days

Let's translate this into numbers.

Inventory	Debtors	Creditors	
$150,000	+$0	-$150,000	= $0

This business may not have significant WC needs.

Profit and cash should be evenly balanced, adjusting for any other capital requirements.

Four Factors that affect Cash Flow

02

Manage Your Growth

When businesses grow, it can be reflected by increased sales, more inventory purchases and larger debtor amounts to collect.

This may lead to increased profits but also a higher Permanent Working Capital requirement.

Growth might cause the business to be short of cash during this time of adjustment and Accounts Payable terms can stretch. If the company isn't prepared for the change, the pains may manifest in other ways.

What if the business doubles in size? Growing WC Days – finding the new normal.

Working Capital Days are still:

Inventory	Debtors	Creditors	
60 days	+45 days	- 30 days	= 75 Days

If the business has doubled in inventory and sales, so will the need for WC.

Inventory	Debtors	Creditors	
$300,000	+$500,000	- $200,000	= $600,000

If this is a "normal" position based on the size of the business, then the amount of cash that needs to stay permanently on hand is now **$600,000.**

Four Factors that affect Cash Flow

03 Track Your Operating Performance (Profit)

Understanding Profit & Loss

A common mistake is to view Cash Flow alone as the key indicator of how your business is doing. A critical part of operating a business is to track your Profit & Loss (P&L) and understand each component.

Key Business P&L Components are:

- Operating Revenue (or Income)
- Operating Expenses
- Cost of Goods Sold
- Gross Profit
- Net Profit (or Loss)

You need to have profitability for sustained positive cash flow.

Where is the cash?

Many a business owner will ask, 'If I have made a profit, then where is the cash?'

Profit and Cash Flow are very different. The amount of cash that flows in and out of your business will commonly vary from the accounting 'Revenue less Expenses' formula that determines your business profit.

Positive Cash Flow ultimately stems from a profitable business over a period.

Where is the profit?

The Profit & Loss Statement is critical to track each month and quarter of the year and from year to year to understand revenue and expense cycles that impact cash flow.

A weak Profit & Loss result is the most impacting and challenging cash shortage issue to solve. Efficient WC management will not make up for the absence of accounting profit.

In this case, you will need to look deeper into the business structure and performance, usually with a trusted adviser to assist you.

Four Factors that affect Cash Flow

04

Sustainable Capital

All businesses require planning to manage how much money needs to stay in the business.

Take what you have learned from analysing Working Capital, Operating Performance and Growth, and use this data to determine how much is available to be withdrawn in dividends, reinvested and/or available to spend.

Using Debt for Capital or Growth

Taking on debt is not always the answer. A business may structurally be under-capitalised, meaning it needs a long-term and sustainable approach to be ready to make the most of funding and handle the repayment commitments.

A good commercial broker and business accountant can work with you to prepare ahead of time.

KEY INSIGHT

Once the Working Capital profile of a business is understood, including what the "normal" amount needs to be, variances to normal are easily seen and reviewed.

A financial mistake is to throw in more debt or capital to an inefficient operation. Now is the time to stop and understand what is causing the problem.

Know what "Normal" is for your Business.

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Five Strategies for Better Cash Flow

How to optimise your financial position

01 Identify your Permanent Working Capital – Is it changing?

This may be due to growth, credit/supplier terms or changed business circumstances. To take action on a problem, you first need to know the size of the problem. If the business is growing, you may need to leave more cash in the business.

TIP: You can't use debt to fill this hole, a mistake many advisers and business owners make.

02 Remediate any weak areas of your WC Cycle (i.e. improved customer collections)

Determine if the weak areas are excess inventory, slow paying customers, short supplier terms, a combination of these or something else?

One customer we assisted had strong Profits results yet was short on Cash. A review found that their Average Debtor days had pushed out to 75 days. By better enforcing their collections policy, they reduced this cycle to 53 days for an annual savings of $185,000.

TIP: Understand your business's normal working capital cycle and be prepared to adjust to a new normal when required.

03 Operating Performance – Take an honest look at the Profit & Loss

Bringing in more cash may not be the best solution in the long term. Could it be the time to make hard decisions? This may include a closer look at your Gross Margin Percentage or Gross Profit Operating Costs.

TIP: The very best businesses always “Focus on the Revenue” along with costs.

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Five Strategies for Better Cash Flow

How to optimise your financial position

04

Finding Capital for Growth

An honest discussion with family members, accountant or a business adviser may be needed if your business needs more equity or capital contribution.

TIP: If business growth is the best strategy, then an Equity strategy, (not Debt), may be the answer.

05

Developing Habits for Financial Hygiene

There are day-to-day financial habits that we know we should do but either don't know where to start or feel too overwhelmed to find the time.

These include cash flow forecasts, reviewing borrowing, your debt profile, tax planning and reporting, receiving a decent salary, and setting realistic business goals.

TIP: You don't have to go it alone. Reach out to experts who can help.

Growing Your Business

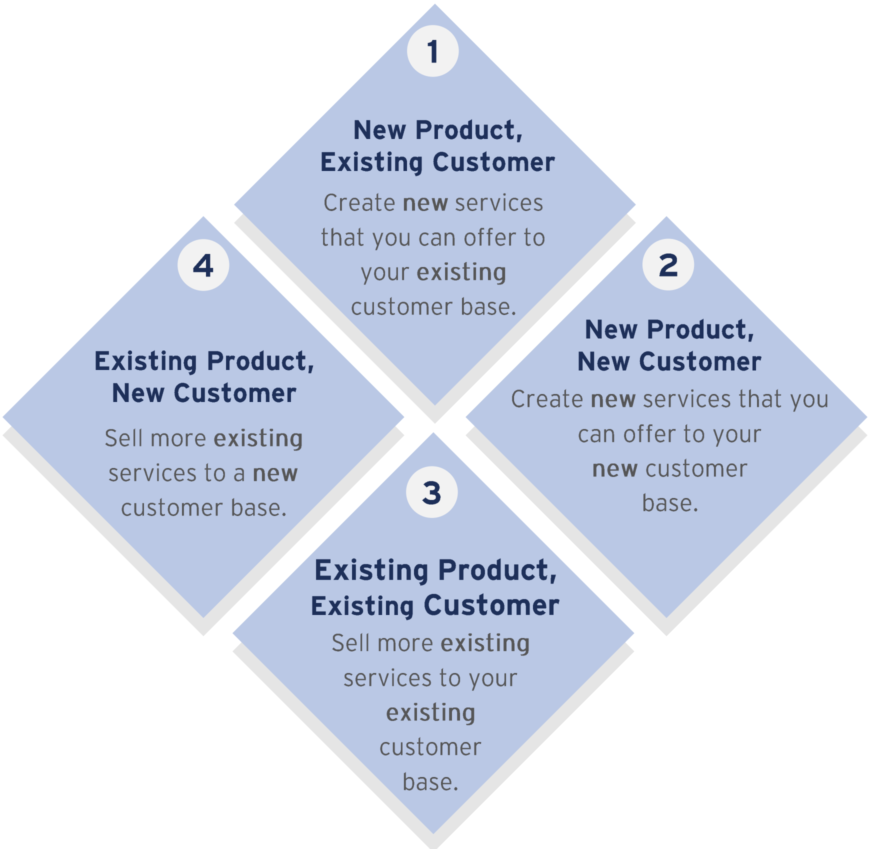
Effective Growth

Now that you understand the working capital needs of your business, you can focus on growing it with confidence.

The Product/Customer Matrix

The most effective options for business growth can be divided into these four categories.

Select one or more areas to focus on first and create a plan to strategically achieve sustainable business growth.



Funding Growth

Now you can approach lenders with a plan for where your business is heading, clarity about the funds you need and a strategy for repayments.

TIP: Only seek funding from lenders who have an appetite for lending to your industry. Talk to an experienced commercial finance broker for guidance.

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What's Next?

Business and Financial Services

Commercial Finance

Broad solutions for corporate, business and property funding of all shapes and sizes, even yours.

Equipment Finance

We act fast to find the most optimal lender to fund your business and personal assets.

Mortgage Finance

From simple to complex, we've seen it all and are here to help. Tell us your story - we are good listeners.

Agribusiness

You'll find advisers that understand the unique needs and seasonal nature of agri industry customers.

Locations

VIC:
Melbourne
Geelong
Western District
Bendigo

NSW:
Sydney
Albury
Tamworth

QLD:
Brisbane
Toowoomba

You need a finance partner with experience.

Our award-winning expertise includes accounting, economics, legal, marketing and strategy. Talk to us, we're good listeners.

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For all your lending needs.