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YOU'RE NEVER TOO BUSY FOR A CASH-FLOW PLAN

BY TERENCE SHEPHERD

One of the primary reasons many businesses struggle, and sometimes fail, is their inability to meet financial obligations as they become due, caused by limited cash resources. No matter how sophisticated your business' processes or how wonderful your products, if your business runs out of cash, it will cease to exist.

Yet many small businesses do not have a cash flow plan, and if they do, it's often an annual projection done to accompany a bank loan renewal or application. To know how much financing you really need, or better yet, to plan and manage your cash flow so that you don't incur the costs of financing, you must perform cash flow and profit planning on a regular basis.

The financial strength of a business depends on if cash flow is positive, available and timely. Positive: Net cash flow should be positive, meaning cash inflows exceed cash outflows. Available: A business must be solvent and hold sufficient cash flow in liquid assets (cash, receivables, etc.) so it can access the cash necessary to meet financial obligations. Timely: Cash inflows must be timed to come in before cash outflows are due.

This doesn't just happen by accident, it takes careful planning. Those businesses that do this successfully have cash flow forecasts that they manage on a regular basis (at least monthly) so that they can plan for any cash shortage and put the necessary measures in place to guide the business through those times when cash is thin.

FORECASTING AND PLANNING CASH FLOW

To ensure a cash flow and profit plan for at least the next 12 months of operations, you need to know: How much cash your business will need; When the cash is needed; and If you will have the cash you need, if you should apply for financing (this process takes time) or if you need to make a capital contribution to the business.

Once you have your 12-month forecast, you should "roll it over" on a monthly or quarterly basis so that it remains current, otherwise it will be out of date soon after you have completed it.

MORE THAN JUST PROFIT

It is possible for a business to be making profits yet have a negative cash flow position. This can be caused by large fixed asset purchases, payment of large debts, and other outlays. As a general rule, you should try to finance your operations out of working capital. If your business needs to purchase an expensive machine or other fixed asset, this outlay of capital should be matched by long-term funding such as a term bank loan or a long-term lease agreement.

Startup businesses generally have cash flow difficulties early on, due to large outlays required to build up the balance sheet or asset base. More mature businesses tend to suffer less from these problems and are generally good cash generators, as their outflows are limited to normal operating activities. However, be aware that there are many examples of mature businesses that have run into cash flow difficulties due to poor management or complacency.

Being mature does not in and of itself guarantee profitability and positive cash flow, and the same principles outlined here apply equally to all businesses.

MEASURING YOUR PERFORMANCE

Cash flow forecasts are useless unless the actual results are monitored regularly. Failing to fulfill or exceeding your assumptions can affect the long or short-term viability of your plan. You need to carefully measure and understand the effects of variations to your plan. Remember, the business environment is constantly changing, and what works today won't necessarily work tomorrow. ■

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