Business Resilience Toolkit

Managing your cashflow profile

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Transcript:

Did you know that businesses can go bankrupt whilst making a profit?

It is important in business to make a profit – or a surplus in not for profits - but it is even *more* important to understand the profile of your cashflow so that you don't run out of cash.

Managing the cashflow is about ensuring that you have enough cash to pay expenses as and when they fall due. You do this by having tight control on the movement of cash and forecasting changes in cash availability.

Hi, my name is Andrew Ellis and I am a business consultant with CBB.

To understand your cashflow profile, you need to ask yourself 3 questions:

1. When are you paid for the services you provide – before, at the time or after?

2. When are your expenses due?

3. Who pays you for your services – Government, big organisations, individuals?

Your cashflow profile can be simply viewed as when cash comes in and out of your organisation.

REVENUE

Let's look in more detail at the money coming IN to your business – REVENUE. Ideally, you want to invoice and be paid as early as possible – whilst understanding any constraints in your market (such as NDIS where you can't charge before the service is provided).

To examine the cash coming into your organisation, look closely at your revenue and when you receive the cash for the revenue you generate. Some businesses can be seasonal and receive the majority of their revenue in a short part of the year, but have expenses incurred across the full year.

Cash related to revenue earned will come in at 1 of 3 time periods:

1. Prior to earning your revenue – this when you are prepaid for the services you provide. An example of this is when a grant is paid to your organisation prior to the services being provided. Grants can result in spiky or lumpy cashflow that can be misleading if the incoming payment needs to cover your expenses for the next 3, 6 or even 12 months.

2. At the same time as earning your revenue – this is where you are paid for the service or product you provide at the time you provide it.

3. After earning your revenue – this is where you provide the service and are then paid at a later date. For example, sending out an invoice and being paid 7, 14 or 30 days after providing a service .

EXPENSES

Now let's look at your EXPENSES in more detail. Most of your expenses will fall due almost immediately (wages) or within 30 days.

To review the cash that leaves your organisation, examine your expenses through the same time periods as the revenue. Often you will find that expenses require a cash outflow at the time they are incurred or very shortly after – an example of this is wages which require a cash outflow shortly after the expense is incurred. Upon reviewing the cash profile of your revenue and expenses you will be in a position to understand the overall cash flow profile of your organisation. If for example you are generally paid 60 days after the revenue you generate and pay your expenses as they incurred then you will have a cashflow gap as there will be a period of waiting to be paid for your services whilst still need to pay your expenses.

You should make sure that you understand the patterns of cashflow income and outgoing expenses.

Mapping cashflow for pervious period of time (e.g. 12 months) will help to see patterns in the demand for cash vs cash available. Assuming your business is operating on similar model, a historical analysis can form the basis of forecasting cashflow and cash requirements going forward.

Using a cashflow forecast and tracking variances can help you to see times when additional action might be needed. If historical patterns show points when there is less cash available to pay bills, you may need to look at ways to mitigate the risk, for example, with business changes, possibly an overdraft facility, or reviewing payment terms with your suppliers – which you may be able to review and adjust to improve your cashflow, e.g. by paying monthly instead of a year in advance.

WHO PAYS?

Our first question has assumed that your clients will pay you on-time – but that doesn't always happen!

We'll now come back to our third question of who pays you for your services – Government, big organisations, individuals? If you are paid after your services are provided then the risk profile of customers needs to be considered.

Cashflow can easily be disrupted when someone is late to pay you. Over time, you will build up a knowledge of how quickly different customers pay you. Some pay quickly and early; some pay on time; and there are some you will just need to chase up.

In taking on new customers, you should keep an eye on how quickly they pay you – and be aware of not providing too many services before payments are made. If this area is a risk for your business, you might need a policy that you will withhold services if payments are more than a certain number of days overdue. This policy needs to consider any potential impact on customers, your reputation etc.As we close out this video, let's come back to the question we started from: Did you know that businesses can go bankrupt whilst making a profit? You can go bankrupt if you run out of cash, or don't have the ability to pay your bills as and when they fall due. If your profit doesn't flow through to cash at the bank, then this is a risk to manage.

The key point from this video is to make sure that you understand and manage the cashflow profile of your business. That means understanding when you are paid for your services, when your expenses are due, and the risk profile of those paying you.

CTA: if this video has been useful, then I suggest that you watch the other CBB video titled “Improve your billing”.

Related video to watch next: Improve your billing.