How To Manage Your Cash Flow

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Even profitable companies can go broke. That’s a difficult truth for start-up business owners to swallow. But the sooner you learn that when you’re out of cash, you’re out of business, the better your chances for survival will be.

Profit is an accounting principle. You need cash, not profit, to pay bills or loans. Furthermore, it’s a matter of having the cash at the right time. If you must pay bills each week—but your customers don’t pay you for 30, 60 or 90 days—your business has a cash-flow lapse for which you must plan. Otherwise, the company will miss profit opportunities, hurt its credit rating and eventually go bankrupt.

Fast-growing companies are especially vulnerable to cash-flow woes, because they tend to hire employees and build inventories faster than their customers pay. Many bankers won’t accept signed contracts as collateral for lines of credit for start-ups. And money borrowed on accounts receivable carries a higher interest rate than a standard loan. The cost of cash—interest on loans—is one of the largest expenses a company has.

Want to take control of your cash flow to protect your company’s short-term reputation and position it for long-term success? Here’s how:

1. Have three plans/budgets. The first plan forecasts high sales, low expenses and everything going better than expected. The second is based on achievable sales and honest expenses. The third specifies how to survive if everything goes wrong.The key triggering mechanism for going from the realistic plan to the survival plan is a sudden or steady decline in sales.

2. Do cash forecasting. The biggest problem for business start-ups, is the owner failing to plan for how much cash the business needs throughout the year. In cash-and-carry businesses, such as retail shops, cash is collected the same day sales are made. But in other businesses, such as consulting, payments usually come in over several months or after the work is finished. Companies that sell seasonal products or services may earn most of their income in a few months, and the cash must last all year.

Business owners must also forecast expenses that aren’t due every month, such as annual insurance premiums. Forecast monthly cash needs for the next six months or year. At the end of each month, compare the forecast with actual financial results, and adjust forecasts, if necessary.

3. Control spending. Projections are only the beginning. Keep an eye on all spending. Always try to keep enough money in the company to get through tough times.

New business owners are often tempted to spend too much for non-essentials. They lease elaborate offices and decorate them with expensive furnishings. After all, they're company presidents now. Entrepreneurs in business for the long haul, however, often have modest offices or start in their garages. They carefully negotiate leases and solicit price quotes from several vendors to find the best value. Such discipline is easier if you have a budget or, plan. Other cost-cutting strategies: Stop selling products that are losing money and avoid buying assets that require substantial cash outlays.

4. Accelerate receipts. One of the simplest ways to improve cash flow is to get customers to pay their bills more quickly. You might offer a discount if they pay sooner or charge a late fee if they're tardy.

Better yet, require payment on delivery. Be very careful about who gets an open account. And if they're ever late in paying they're back on COD. Tell customers upfront, I want your business, but I can't afford to carry you for 30 days, and most people understand that.

5. Accumulate salary. If necessary to maintain a positive cash flow, you may have to go without a salary. (This is why many experts recommend having one year's living expenses saved up before you start your business.) Many entrepreneurs go bankrupt because they don't pay attention to the financial state of their businesses and insist on paying themselves big salaries no matter what.

6. Keep inventories lean. Too many business owners buy inventory based on hopes and dreams instead of what they can realistically sell. Keep your inventory as low as possible. Remember, a sale that nobody pays for isn't a sale.

7. Add employees cautiously. Fast-growing companies often find themselves in cash-flow crises because they build their work forces based on contracts that may not pay off for months.

Delay hiring workers as long as you can. Instead, look for ways to maximize your own productivity and that of any existing employees or consider lower-cost alternatives, such as outsourcing work to independent contractors.

8. Lease rather than buy. Equipment such as computers can increase productivity, however, lease rather than buy to save cash. A lot of companies go this route with company cars, because the lease payments are tax-deductible.

9. Sell unnecessary assets. If you buy rather than lease assets, consider selling unnecessary equipment to raise cash. This "garage sale" can include company cars, inventory or equipment.

10. Recycle and reuse. Never throw away something you'll need again. Reuse file folders, computer disks and packing boxes.

If you want to be successful, you need to learn about budgets upfront. A lot of start-up business owners lack financial knowledge and get into trouble down the road.

As we have said over and over again, if you need to take a class, seminar or buy manuals and books on areas you are unfamiliar with.

Remember, the first day you stop learning is your first day out of business.

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