

Cashflow is Key

Understanding and managing your cashflow is crucial for business survival

Cashflow crisis can hit any business. Take one of the world's most successful companies, Virgin. Every time they looked like they were going to fall over, was because of cashflow. So forget big profit, know your cash.

Symptomatic of a cash flow crisis is the inability to pay creditors and taxes. If you find yourself wondering where you are going to get the money to pay wages or if you start using the IRD like a bank, or if you are not paying yourself a reasonable wage and find yourself lending money to your business all the time, then you have a problem.

So why do businesses fall into a cash flow crisis so readily? Here are some of the main reasons.

- Non viable business model. The business is not achieving break-even point, where all costs of the business are being met by the income received by the business. This could be for a number of reasons such as poor sales, unsustainable pricing, unsatisfactory marketing, and such like.
- Business grows too fast without understanding how business growth will affect cashflow. If you grow so will your debtors and creditors, you may need to invest in new machinery that will require cash up front and a long term pay off.
- The myth that income tax in the first year is tax free. This ideology always stings businesses when in the second year they suddenly have two years worth of tax to pay.
- A lack of understanding of the Provisional Tax system. This is a relatively complex system and penalises good performance in business where you must forecast and pay the tax in advance. Tax is payable on an accrual basis, which means you might have to pay the tax before you have received the money from your customers.
- Using Inland Revenue like a bank. This is a poor financing tool and results in significant penalties and interest at a rate more akin to a credit card company.
- A lack of understanding of your business cash flow cycle. How long does it take from the moment you incur the costs to put your business into a position to make the sale until you actually receive the cash from the customer. Unforeseen business costs such as; repairs and maintenance of equipment; a contract falling through; a rise in supplier prices.

The solution is knowing your business cash requirements, and planning for cash. First you must know you have a viable business. Will your projected sales generate enough margin to meet all your cash requirements, including drawings and taxation? Next, a cashflow forecast is critical to your business survival. It helps you to understand the upcoming obligations and the timing of these payments. Build a cash flow model, improve the internal accounting function, focus on debtor's collections, stock management and put in place a taxation forecasting and savings scheme.

Here are some basic rules to stick by:

- Build a monthly cashflow for the next year, based on your budget. Compare the actual to your forecast and then update your forecast.
- Have a daily cashflow model so you know exactly where you are every day. This can take about 5 minutes each day.
- Create a culture of cost awareness for everyone in your business. Ask yourself this question, "Will that money spend make me more money than the amount spent?" some times this is very hard to do.
- Pay your future tax obligations based on prior year profits, forecast current year profits and make additional payments where required.
- Learn that profit does not equal cash. Find out what is sucking the cash out of your business.
- Focus on debtor collections and bad debts. Consider using a debt factoring company where required.

- Know your businesses break even point. Ensure this is being achieved before any business luxury items are purchased.
- A growing business chews through cash like nothing else so if you are planning to grow, make sure you have cash reserves or some other plan to solve your impending cashflow shortage.
- Get debt pre-approved before you actually need it.

Remember cash flow is the base element of business. Plan for cash, know and understand your business, spend wisely, save for the future.

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