



## Managing cash flow in the growth stage

For many small businesses, growth is the barometer for success. But expansion can present challenges and one of the critical issues in any company when it is experiencing a healthy level of growth is cash flow. In this article, we look not only at the reasons why cash flow is important and why growth often contributes to a lack of funds, but also some suggestions as to how monitor your cash flow over time and how to improve it.

Cash flow basically means 'Do I have enough cash in my bank account to cover my expenses?' Sounds simple, but you'd be surprised at how many people ignore this.

So why is cash flow critical in growth? Because that growth is often represented by increased investment in debtors and infrastructure. In addition, growth in sales sometimes leads to an increase in inventory holdings in order to meet those sales on time, so the amount of cash tied up in debtors and stock is increased. While these assets may represent the profits earned, they can't be used to pay the wages bill each week. It's all a matter of timing – if your debtors pay on average within 30 days, you still need to have enough cash on hand to pay your trading expenses for those 30 days. And if you can't meet your ongoing expenses you can't continue the growth.

Some of these expenses can be deferred for payment, such as trade suppliers, and the difference between your level of current assets (debtors and inventory) and your current liabilities (creditors and tax accounts) is your working capital requirement.

So why don't companies realise the importance of cash flow? Probably because:

1. Companies aren't realistic in their budgets and cash flow projections – they often overestimate sales revenue and receipt of same and underestimate their expenses.
2. They often confuse profits with revenues and outgoings and don't understand the timing difference.
3. They don't see a cash shortage in the near future and they run out of money as by then it's too late to arrange short-term financing etc.
4. Companies sometimes believe they can push back creditor payments to free up cash for expenses, but then they can experience difficulties in ensuring supply of materials.

You can have the most amazing service or product in the world, but if you run out of cash, it won't matter.

### **What to do about it**

In order to keep track of your cash flow, you'll need a simple spreadsheet tool such as Excel. You need to review how much money will be coming into the business as well as how much money will be going out. Some of the points to keep in mind are:

- Don't assume that all debtors pay within 30 days – look at your past history and be realistic.
- Take a serious look at the capital costs of growth – expansion is costly and will likely cost more than you estimate. If you are, for example, considering upgrades of plant and equipment keep in mind that there are installation costs to be funded as well as purchase costs.
- You need to consider a number of scenarios such as 'What if that big order suddenly comes in?', 'What if that big order is cancelled?' or 'What if that important client goes under owing me money?'

- Understand the relationship between growth and variable and fixed costs.

Most businesses understand the relationship between sales and direct costs, but many overlook the fact that most fixed costs are finite in their capacity to support that growth. Take the rental of premises as an example – a company has that fixed cost which will enable it to generate production only up to a certain level. Any more growth, and the company will be forced to move to larger premises and incur higher rental costs. These sorts of costs are incurred in ‘steps’ and it is important to know at which point the business faces its next step.

Using a spreadsheet to analyse ‘what-if’ situations will enable you to easily see what the effects are of moving to those stages, and also of, say, losing a client or bringing in a large one-off order.

We would suggest that a cash flow projection be for at least 12 months and preferably 24 months. That way, if you see a cash shortage on the horizon, you have sufficient time to explore avenues to cover that shortage. Develop an expansion plan and make sure that it covers both short- and long-term goals, and that the cash flow projection supports the plan. This is the time to determine not just how you're going to expand, but why. If you feel that you don't have a strong business case once you actually see it in writing, you might want to put your plans on hold.

Once you've identified the gaps in your working capital, put plans into place to fund those gaps. Shareholders and other investors can sometimes provide this cash injection or it may be sourced from banks and other finance providers.

Short-term financing such as a line of credit (LOC) can be used to make emergency purchases or to bridge the gap between month's-end payables and receivables. An LOC can be negotiated with your financial institution, and this should be done before any need actually arises. It's usually easier to negotiate an LOC when you don't really need one.

Match the debt structure with your needs and limitations. For example, If you are financing your sales invoices, remember that retentions of around 20% are usual – if your gross profit margins are only 10% you will run short of money very quickly.

### **Tips for keeping your cash flowing**

Hopefully you're convinced of the importance of watching your cash flow, but how do you keep it healthy? Here are some useful tips to watching and monitoring your cash over time:

1. **Spend as little as possible.** This is especially important in the early days of your business. Before you make any purchases, ask yourself 'Do I really need this?' If not, you can live without it for the time being.
2. **Be brutally realistic.** Always overestimate your expenses and underestimate your income. Your cash flow should always be a 'worst-case scenario'. If you know you can stay in business when things aren't going well, then you know you'll be just fine if the best-case scenario happens.
3. **Chase invoices the minute they're late.** It may sound harsh, but the minute that an invoice is late, call the company and start pressuring them. If they think they can get away with late payment, then they'll put you behind all the other customers they have to pay.
4. **Update your cash flow regularly.** As time goes on, you'll realise that some of your predictions about income and expenses were wrong. When this happens, update those figures to make your cash flow realistic. We would recommend updating your cash flow weekly. Once you've got a year under your belt, monthly updates will probably be enough.

5. **Cut expenses as much as possible.** Have a hard look at the expenses column on your cash flow. Is there anything you can find a cheaper deal on? Anything in there that isn't absolutely vital? Saving just a few dollars per month will really add up.
6. **People don't always pay on time.** When planning your cash flow, always account for the fact that it usually takes people longer to pay you than you think. Make sure that your cash flow doesn't depend on certain invoices being paid on time. If your cash flow is dependant on a specific invoice being paid on time, make sure to communicate with the company at least four weeks before it's due to ensure it will be paid on time.
7. **Know your expenses.** Have a good sense of when bills are due, and take into account any discounts for paying bills early as well as penalties for paying late. Create a schedule of recurring expenses like payroll, rent, utilities, etc. This information can identify which bills can be paid at later dates, and which must be paid immediately. Manage your payments carefully.
8. **Manage your sales Invoices.** For those big orders, you may want to consider progressive invoicing while you manufacture the goods or deliver the service. For example you can ask for a deposit with the order and then a percentage of the payment at various agreed upon milestones.
9. **Monitor your Inventory.** Analyse inventory turnover to determine which items are selling and which are duds that are soaking up your working capital. Try to keep inventory levels as lean as possible, so that your working capital isn't tied-up unproductively and unprofitably.
10. **Work out your debt structure.** Secure financing for every stage of the expansion before you begin, including contingency financing. Sources might include company profits, personal investments, loans, and lines of credit. Your plan should include the ability to pay back outstanding debt within a reasonable time

The key to managing your cash flow in the growth stage is monitoring. Know in advance where your cash is coming from and going to, and you will be in a better position to enjoy the fruits of your growth and success!

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