

A guide to business cash flow management ➤



ASB

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Cash flow management

What is cash flow management?

For a business to be successful, good cash flow management is crucial. Cash flow is the primary indicator of a business's financial health as it's the measure of your ability to pay your overheads such as rent, insurance and wages, and expenses like invoices from your suppliers

Ultimately, effective cash flow management is a key business skill and will help protect the financial security of your organisation. Good cash flow management is a balancing act, juggling your cash inputs and outputs.

Does your business have sufficient cash flow?

- Do you ever fall into overdraft by mistake and have to arrange a quick meeting with your bank?
- Do you have seasonal cashflow shortages where you struggle to meet business overheads or pay wages?
- Do you receive unexpected bills that you have to ask for an overdraft to pay?
- Are you waiting for your customers to pay you so that you can pay your suppliers?

If you have answered yes to any of these questions, your business may have cash flow management issues. This guide could give you a better understanding of how it all works and help you to make changes to gain more cash flow control.

Advantages of good cash flow management

- Know where your cash is tied up
- Plan ahead to spot potential problems and act in advance to reduce their impact
- Minimise interest charges
- Identify surpluses which can be invested and earn interest
- Be more in control of your business and make informed decisions for future development and expansion.

Some of these benefits we'll look at in more detail later on in this guide.

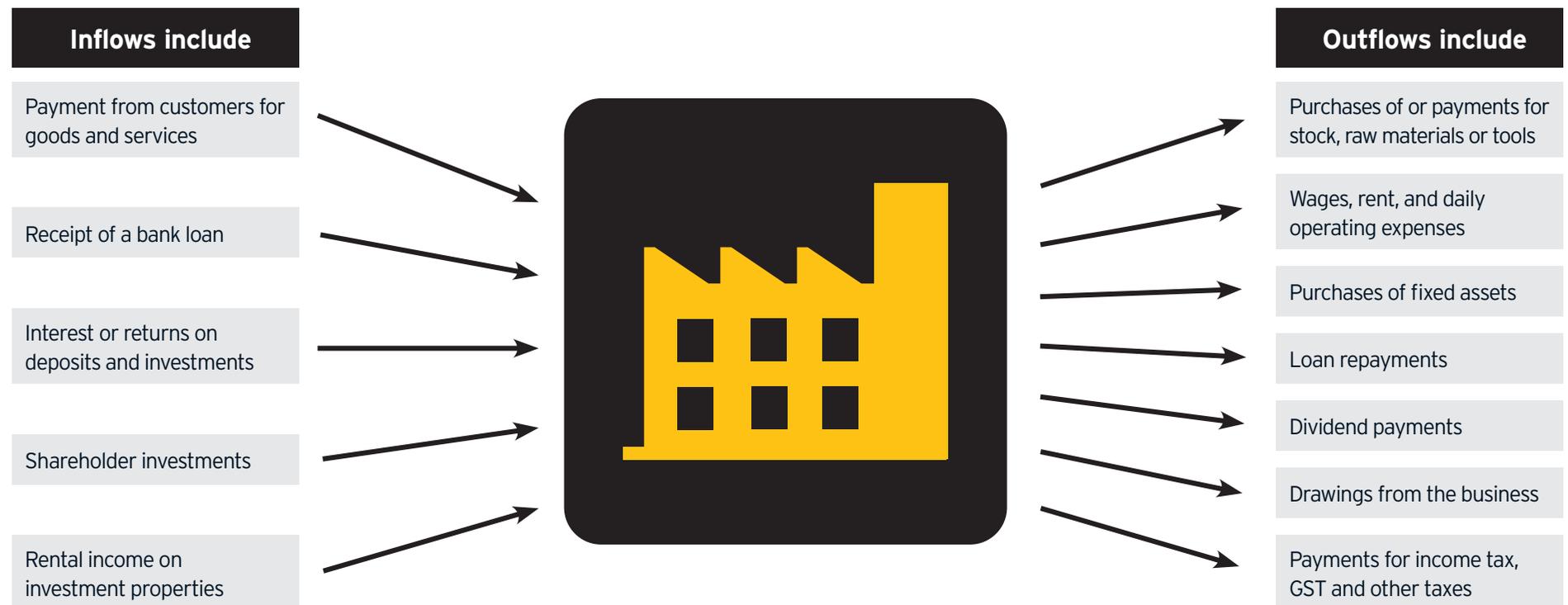
The basics - forms of cash

Cash includes:	Cash does not include:
Coins and notes	Money you owe suppliers
Foreign currency and accounts that can quickly be converted to NZD.	Long term borrowing
Your market	Money owed to you by customers
	Stock & investments

Cash flow management (continued)

Cash shortfalls and surpluses

Successful cash flow management depends on the timing and amounts of money flowing into and out of your business. Income and expenditure rarely occur together, with income usually lagging behind. Good cash flow management will help you to prepare for shortfalls and to make the most of cash surpluses.



The difference between what you get in and what you pay out is either your cash surplus or shortfall.

Cash flow management (continued)

The difference between cash and profit

It's important not to confuse cash balances with profit. You may be able to forecast a good profit for the year, yet still find yourself strapped for cash.

$$\text{Profit} = \text{total business revenue} - \text{costs}$$

The income earned or expenses incurred are usually assessed over a period of a year. Cash is more immediate and can be worked out on a day-to-day basis. Sometimes profits are not enough to cover the cash required to keep up with the required growth in areas like stock and money owed by customers.

Practical steps to managing cash flow

Prepare a budget

You should have a budget to help you measure your business's actual performance against a benchmark. Budgeting can help you prepare for the future and foresee problems before they occur. Your bank may also ask you to provide a budget in addition to a business plan, if you need to apply for finance.

A budget is usually set for a business's financial year. This should be the maximum period that you budget for. It is common to split the budget into monthly statements to make the process more manageable but many businesses budget on a 1-4 week cycle. To be useful, they should cover a period that will give your business some direction to go forward.

Forecast your cash flow

Preparing a cash flow forecast encourages you to think ahead and consider what the next twelve months may bring. You can gain some forewarning of the good and bad times ahead, and also compare your forecast cash position with what actually happened.

The forecast is usually done for a year or quarter in advance and divided into weeks or months. It's best to pick periods during which most of your fixed costs (such as salaries) go out.

The forecast generally includes your:

- Cash receipts
- Cash payments
- Excess or shortfall of receipts over payments - with negative figures shown in brackets

- Opening bank balance
- Closing bank balance

It's important that you base initial sales forecasts on realistic estimates. If you have an established business, a good method is to combine sales revenues for the same period 12 months earlier with predicted changes. If you don't have at least 12 months trading behind you, you'll have to estimate some figures. You may want to ask your accountant for advice here.

ASB's Business Cash Plan

ASB's Business Cash Plan is an online cash flow management tool that can help put you in control of your business finances by allowing you to track and manage your cash flow, using numbers directly from your ASB accounts.

ASB's Business Cash Plan is available through FastNet Classic and FastNet Business. It costs \$5 per month for FastNet Classic customers but you can try it free for the first 90 days. There is no charge for FastNet Business customers as this is included in the monthly fee.

For more information about ASB's Business Cash Plan, visit our website or give us a call on **0800 272 222**.

There are also other cash flow management tools you can use including:

- Sorted.org.nz
- Xero
- MYOB Cashbook

Practical steps to managing cash flow (continued)

2 steps to basic forecasting

Putting your cash flow forecast on paper will give you the following:

- A format for planning the most effective use of your cash
- A schedule of anticipated cash receipts
- A measure of the significance of unexpected changes in circumstances e.g. reduction of sales
- An estimate of the amount of money you need to borrow in order to finance your day-to-day operations.

1) Estimate the money you'll receive each month - including sales, invoice payments, loans, funds from shareholders etc. Estimate based on when you'll actually receive the cash, as opposed to when you send out the invoice. This will help you understand whether you are collecting payments for the products and services you are providing in a timely manner. Typical examples of overheads expenses include:

- Bank and finance charges
- Insurance
- Mail and office supplies
- Purchasing raw materials
- Travel and accommodation
- Other
- Marketing and customer communications
- Rent
- Maintaining stock inventory
- Wages and benefits
- Vehicles

The next step is to make cost estimates for each area. Sometimes it will be a matter of calling your suppliers and asking for a quote. Alternatively, you can use your previous history as a guide, making sure that increases and decreases in cost are consistent with your revenue objectives.

There are various different types of accounting software that can help you produce an accurate assessment of where your business is at. Some of the bigger brands include Quicken, MYOB and Xero.

	April	May	June
Start Position	\$90,000	\$83,478	\$88,498
In flows			
Receipts from debtors	\$12,567	\$7,892	\$11,450
Cash sales	\$23,576	\$30,452	\$28,750
In flows subtotal	\$126,143	\$121,822	\$128,698
Outflows			
Cash Purchases	\$2,500	\$3,000	\$3,500
Payments to suppliers	\$24,899	\$15,678	\$18,900
Rent	\$3,000	\$3,000	\$3,000
Wages	\$10,587	\$9,870	\$10,000
Communications	\$560	\$589	\$560
Insurance	\$432	\$432	\$432
Utilities	\$687	\$755	\$755
Outflows subtotal	\$42,665	\$33,324	\$37,147
End Position	\$83,478	\$88,498	\$91,551

2) You should now be able to calculate your net cash flow. Net cash flow is a measure of your company's financial health. Net cash flow is the balance remaining after you have deducted cash outflows (operating expenses, financing costs etc.) from your cash inflows.

You could take your forecasting one step further and use it to see how your cash flow would be impacted if your sales or costs increase or decrease by different rates (i.e. 10 or 20%). It's a good way to consider what financial options you have in best and worst case scenarios.

03 Improving everyday cash flow

Here are some practical tips that you could apply to improve your day to day cash flow. Cash flow management procedures require major attention, particularly regarding debtors and stock.

Managing debtors

Ask your customers to pay sooner

Offer a discount for prompt payment and provide them with a bank account number so they can make an electronic payment. This saves receiving cheques in the post that need to be banked. This all takes time and the money could be in your account much quicker.

- Design your invoices so that they're brief, clean and clear
- Review your invoicing and payment terms. E.g. 7 days instead of 30
- Offer prompt payment discounts or late payment penalties
- Don't allow prompt payment discounts to be taken outside the agreed credit terms
- State your payments terms in writing on all invoices
- State internet banking as your preferred method of payment

Chase debts promptly and firmly

Are your customers paying on time? Do they have a good payment track record? If not, then this means you'll spend more time chasing their payments.

- Learn each debtor's payment cycle and ensure that your invoice is approved and included in the payment run
- List all accounts receivable past due in order of size and due date. You'll be able to recognise trends showing where some of your customers regularly default on their payments
- Put clients who are late payers on a cash only basis
- Advise that you will withhold goods and services in the future if payment is not made

Have a credit policy

Many collection problems are created before a debtor exceeds credit limits due to incorrect or non-existent credit policies.

- Credit checks for new customers are important
- Credit reviews for existing customers may be necessary if circumstances change
- Agree payment terms when you set up accounts for new customers

Managing stock levels

Major issues occur when large sums of money are tied up in high stock levels. You need to balance holding adequate stock levels with having enough to satisfy customer demand.

- Be more efficient with stock management
- Order less stock more often
- Make "Just-In-Time" (JIT) delivery arrangements with your suppliers. JIT is an inventory strategy implemented to improve the return on investment of a business by reducing in-process inventory and its associated carrying costs.

04 How to manage cash flow surpluses and short shortfalls

If your business creates a surplus, you have choices:

- Put the surplus in a short-term term deposit or a business savings account to earn interest until you need it
- Use it to fund expansion plans in line with your strategic business plan
- Make advance payments to your creditors to enhance your credentials

If you have cash flow shortages, there are a few funding options to consider:

- Review your current overdraft limit with your bank
- Establish a lending facility where you can withdraw funds at short notice. Talk to us about the facility limits, the repayment periods and the interest rates
- You could establish an overdraft facility so that you can make withdrawals. Talk to us about setting up an overdraft that allows you to respond quickly to an opportunity or an unexpected challenge to give your business a competitive edge
- Business credit cards are also a handy short-term cash flow management tool. ASB also offers True Rewards so that you can earn rewards points when using your business credit card.
- For long-term needs, talk to us about fixed term finance solutions

Analysing your financial health

You can use some calculations to give you an indication of your business' cash flow health. Here's some that might be useful to know:

1	Current ratio: $= \frac{\text{current assets}}{\text{current liabilities}}$	A measure of a business's ability to meet its short-term debt obligations. If the current assets of a company are more than twice the current liabilities (current ratio > 2), then that company is generally considered to have good short-term financial strength. If current liabilities exceed current assets, then the company may have problems meeting its short-term obligations.
2	Quick ratio: $= \frac{\text{current assets} - \text{inventories}}{\text{current liabilities}}$	A measure of a business's liquidity and its ability to meet its immediate financial obligations. It is the amount of liquid assets available to offset current debt. The higher the ratio, the stronger the business's liquidity. A healthy business will always keep this ratio at 1:1 or higher but ratios also vary between industries.
3	Receivables turnover ratio: $= \frac{\text{net credit sales}}{\text{average accounts receivable}}$	A measure of how long it takes, on average, for a business to collect bills owing to it. A high turnover figure is desirable, because it indicates that a company collects revenues effectively, and that its customers pay bills promptly. A high figure also suggests that a business's credit and collection policies are sound. A low ratio implies the business should re-assess its credit policies in order to ensure the timely collection of imparted credit given to customers that is not earning interest for the business.

04 How to manage cash flow surpluses and short shortfalls (continued)

4	Creditor days: $= \frac{\text{suppliers bills} \times 365}{\text{annual sales}}$	Measures the number of days on average a company requires to pay its creditors. Creditor days are an indication of a company's creditworthiness in the eyes of its suppliers and creditors, since it shows how long they are willing to wait for payment. Within reason, the higher the number the better, because all businesses want to conserve cash. However, a business that is slow to pay its bills may be having trouble generating cash.
5	Debtor days: $= \frac{\text{trade debtors} \times 365}{\text{sales}}$	Measures the average time payment takes. Increases in debtor days may be a sign that the quality of your debtors is decreasing. The lower the number of debtor days, the better. Any changes in the number of debtor days may reflect a change in how the business operates or its environment. This is not necessarily a bad thing but it could indicate a potential cash flow issue.

Talk to your accountant if you're not sure how to use these ratios.

Managing cash flow gaps

You can also improve cash flow by borrowing, or putting more money into your business. This is suitable for short-term downturns, but definitely shouldn't form the basis of your cash strategy. Your overdraft should be sufficient to cover highs and lows of seasonal business variations. Your bank account shouldn't permanently remain in overdraft but should move in and out of overdraft throughout your business cycle.

Get in touch

If you'd like to talk to someone in person about cash flow management, feel free to contact the ASB Business Banking team on **0800 272 222** or email **businessbanking@asb.co.nz**.

Whether you have local or international ambitions for your business, follow us on [LinkedIn](#) to connect with the knowledge, advice and people to help you achieve your goals.

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