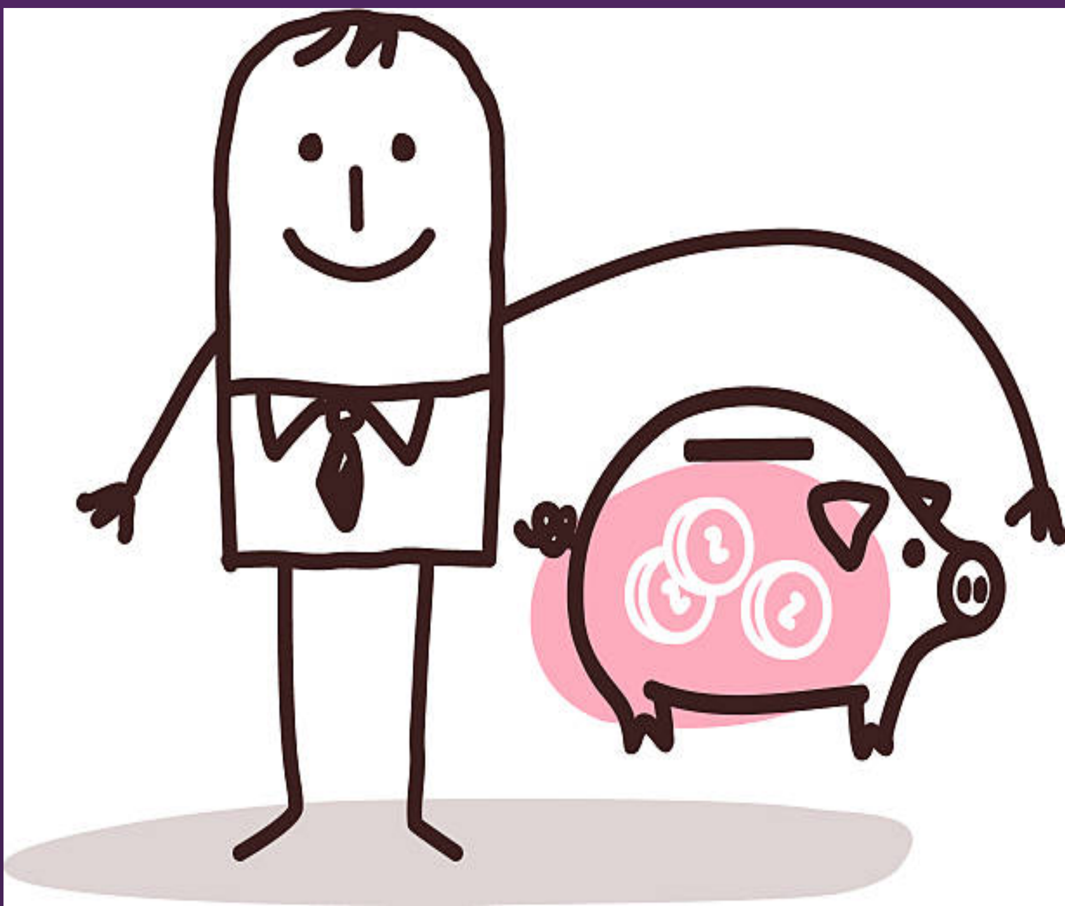
Q2's Cashflow Improvement Guide



Accountants & Business Strategists

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1 Executive Summary

It is impossible to successfully grow as a business unless it's both profitable AND generates surplus cashflow on a sustainable basis.

The ability to generate positive cashflow year in and year out is essential for a business to be viable in the long term. Inadequate cashflow is a symptom of management problems in a business, NOT the cause.

While there are some "quick fixes" to improve cashflow, for example getting a temporary bank overdraft or delaying payment to suppliers, these are bandaids. A more intelligent approach is to understand the drivers of cashflow in your business and then change your processes to improve cashflow on a long-term basis.

To improve business cashflow:

1. Create a cashflow forecast
2. Understand your key cashflow drivers
3. Change your business processes
4. Monitor, measure and fine tune.

2 Profit does NOT equal Cash

Many business owners are in disbelief when they receive their annual financial statements from their accountant showing a profit (and tax to pay) for the year… "The business has no spare cash – so your figures must be wrong – there is no way I made a profit and I shouldn't have any tax to pay!"

Profit is calculated by matching revenue earned and the expenses incurred in earning that revenue.

Cash on the other hand is is affected by how long our customers take to pay us, how long it takes us to pay our suppliers, whether we are growing as a business, what we are drawing out of the business in personal spending, our loan repayments, our income tax payments and the new assets we need to buy (for example, a new truck) from time to time.

The chart below summarises some of these differences:

	Profit	Cash
GST	✕	✓
Loan repayments	✕	✓
Interest on loans	✓	✓
Cash spent on assets	✕	✓
Cash received from sale of assets	✕	✓
Depreciation	✓	✕

The link between profit and cash is timing – known as the Cash Conversion Cycle.

3 Measure your "Cash Conversion Cycle"

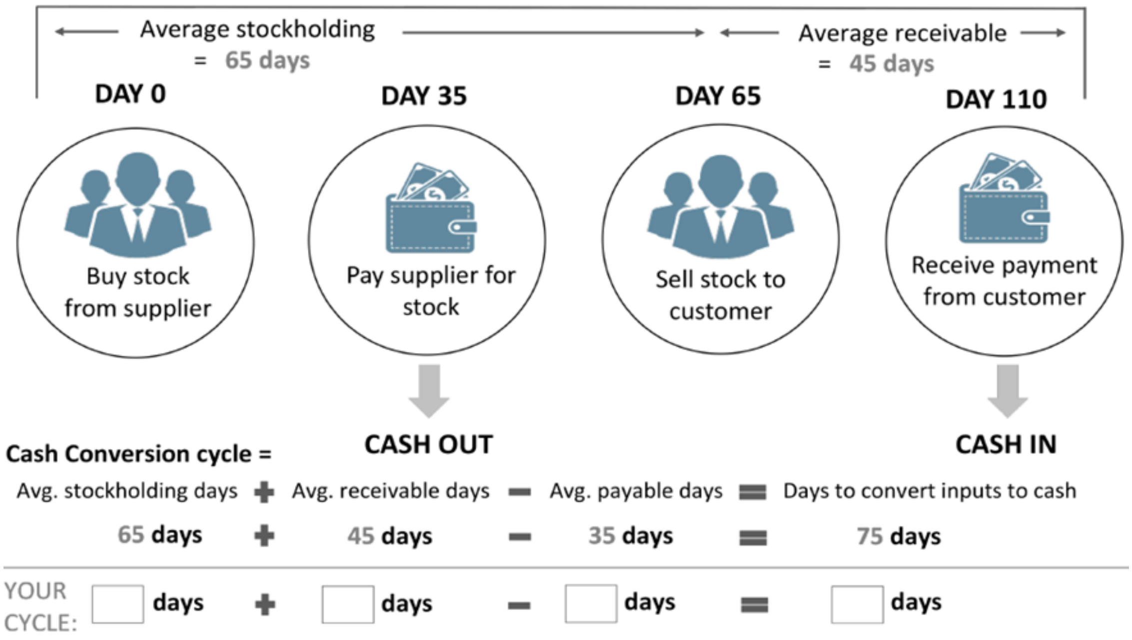
Your cash conversion cycle is the number of days it takes to recycle cash in the business. The shorter the cycle the more liquid the business and the better the cashflow.

The cycle starts when stock is ordered and wages paid, it continues through the production and service delivery phases. Once the goods are sold or the service is delivered an invoice to the customer can be raised, but the cash conversion cycle does not run full circle until the customer actually pays the invoice in full.

Businesses who do not offer credit will often have a shorter cash conversion cycle. But even cash businesses may have extended cycles if other business processes are inefficient, for example production processes are slow or supplier terms unfavourable.

Measuring and reducing your cash conversion cycle is a key to improving cashflow. Indeed, thousands of dollars (or hundreds of thousands!) of cash can be released to a business without any additional sales… simply by reducing the cash conversion cycle.

The Cash Conversion Cycle



4 The seven causes of poor cashflow

There are many causes of poor cashflow. Here are the top seven:

1. Poor accounts receivable process - resulting in debtor days (the time between billing and banking) being too high, stifling your cashflow.
2. Accounts payable process - a review of all suppliers' terms may identify ways to improve cashflow or just get better Terms of Trade.
3. Carrying stock for too long means full shelves but an empty bank account. This is no different if you're a service provider with work in progress that is yet to be billed.
4. Maybe your debt / capital structure needs to be reviewed. Perhaps your debt should be consolidated and paid off over a longer term. Maybe you need to have an honest look at your drawings from the business, or the business needs an injection of capital to fund its growth. Often significant cashflow and interest charge improvements can be achieved with a regular review of existing debt.
5. Overheads. Every business should do a thorough review of its overheads every year.

6. Low gross profit margins is another way of saying that your variable costs are too high. There are many strategies that you can implement to improve margins.
7. Finally, sales levels just too low to support overheads and other cash demands on the business. This comes down to how viable the business is right now. If the business is in high growth mode, and sales are increasing rapidly, then the business needs finance to support that growth, and we need to review a financing plan. If the business isn't in growth mode, we need to focus on how we grow sales.

5 It's not a quick fix

If you want to lose weight you can go on a crash diet and the kg will come off. But unless you make sustainable long-term changes to your diet, the weight will inevitably be regained. Quick fixes to business cash flow are the same. If you apply a bandaid your business is likely to lurch from one cashflow crisis to another, or fail completely.

Fixing the underlying causes of poor cashflow in your business needs a deep understanding of your cashflow drivers and then the tenacity and commitment to work on them until the underlying business processes support ongoing sustainable cashflow. This work requires a planned and structured approach and usually the assistance of an outside expert to guide the process, and keep it on track.

6 Q2's cashflow improvement coaching

Q2 offer cashflow improvement coaching that starts with the preparation of a cashflow forecast and calculation of the cash conversion cycle. Month by month Q2 then systematically works through the seven causes of poor cashflow with the business owner, and business process improvements are identified and executed throughout the coaching programme. A reduction in the cash conversion cycle, improved business processes, and improved cashflow are the desired coaching outcomes.

Most business owners are just too busy to be able to work through such a process on their own. Having an outside cashflow improvement coach holds the business owner accountable, and creates the discipline and structure to achieve lasting results.

7 Ongoing monitoring and fine tuning

The discipline of preparing an annual cashflow forecast, entering your budget into your accounting software, and generating monthly reports to measure and monitor is important to business success. Continually monitoring and improving your cash conversion cycle will help keep your business healthy with sustainable cashflow to fund expansion and growth.

8 Conclusion

Adequate cashflow is critical to business survival and growth. A systematic approach is needed to improve cashflow on a long-term basis. An outside coach can provide the knowledge, commitment, structure and accountability to help business owners change the underlying business processes that will create lasting improvements and sustainable cashflow.

To find out more about how Q2 can help, phone 09 222 4448 or email info@Q2.net.nz to set up an obligation-free first meeting.