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How to deal with a cash crunch

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When businesses go under, it's usually not because they're not making a profit, but because they don't have enough cash to pay their bills.

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Greg Hayes, director of Hayes Knight professional services firm, says many small businesses fail to differentiate between profit and cash flow.

Most business do profit forecasts, but many fail to forecast their cash flow – the amount of cash coming into and going out of a business and when.

“The difference between a cash flow budget and a profit budget is simply timing, but if you're not aware of what that timing looks like you can get yourself into trouble really quickly,” says Hayes.

“Most businesses that go broke go broke because they run out of cash, not necessarily because they're not profitable. There are plenty of profitable businesses that have ended up in administration and that simply is because they're run out of cash, despite the fact that they're making some profit.”

Businesses need to do a reliable cash flow forecast of cash coming in and cash going out, forecasting when customers are likely to pay and when expenses such as rent, loan repayments, equipment hire, bills and tax are due.

There are only two ways to improve a business's cash flow, accelerate cash collections or slow down cash expenditure.

Here are some tips:

TIGHTEN UP ON CREDITORS

Cash flow crises are often brought about by slow paying creditors. The first step is to chase up those who owe you money for payment, even before the debt fall due, says Brad Callaghan of advisory firm Callaghan Partners.

Next reduce payment terms. “A lot of businesses offer 90 day credit terms, but you can't do that if you're suffering a cash flow problem,” says Callaghan, who advises offering just seven days credit.

SACK BAD CUSTOMERS

Businesses are focussed on winning more customers and are naturally reluctant to let any go, but Callaghan says some aren't worth having. “If you've got people who are not paying, don't deal with them anymore. There's no point in supplying a product if you're not getting paid for it.”

TALK TO YOUR SUPPLIERS

Greg Hayes says businesses should get in touch with their suppliers to whom they owe money and explaining that cash is tight and letting them know when you'll pay.

“The advantage of being upfront with your suppliers is that at least they get a sense that you know where your business is up to and that you’re being honest with them,” he says. “That’ll buy a little bit of breathing space, but it depends on exactly how good your relationship is with those suppliers.”

But businesses have to honour their promises and pay when they said they would, or they’re unlikely to be offered favourable terms again.

GENERATE QUICK CASH

A quick way of generating cash is to offer a discount of a few per cent to someone who can pay straight away. “Sometimes giving away a bit of your profit to get cash immediately moving along,” says Hayes.

“This is why you absolutely need to know your cash position and your profit position, because you don’t want to give away profit if you don’t need to, and you need to also know that you can afford to give away that profit.”

Also, don’t carry excess trading stock and consider holding a sale.

For service industries, ask the customer for a deposit up front and for progress payments, rather than waiting until a project is completed.

LOOK FOR INTERNAL FUNDS

nabbusiness says that before seeking external funding to get over a cash flow crisis, companies should look to see whether they have an internal source of extra funds by freeing up cash within the business.

The bank suggests asking suppliers to take back excess stock or extend better credit terms; and reducing drawings from the business until revenues improve.

Companies can also sell underused assets and rent the equipment instead, and downgrade or sell vehicles and lease them instead.

INCREASE PRICES

Are you charging enough for your products or services? A small price increase is less likely to upset customers, particularly if you’re charging less than your competitors, and will help bring in more cash.

This story was found at: <http://www.theage.com.au/small-business/finance/how-to-deal-with-a-cash-crunch-20120515-1yo8w.html>