Finance

Introduction to Cashflow

MANYRIVERS

Business Foundations

Topics Covered:

- What is Cashflow?
- Cashflow Management
- Interpreting Financial Statements
- Golden Rules to Managing Cashflow

Good cashflow management is absolutely fundamental to the success of your business. 90% of businesses fail because they don't manage their cashflow well. Here are some tools you can use to really get on top of it.

What is Cashflow?

Cashflow is all about cash coming in and going out of your bank account. When you have more coming in than going out, you have a positive cashflow. When you have more going out than coming in, you've got a problem.

Don't confuse cashflow with profit. Profit is how much money you have once you add up all your income and subtract all your expenses over a given time. Cashflow is about the flow of money coming in and going out of the business over a given time.

For most small businesses, the biggest cash inflow comes from making sales. Outflows are things like payments to suppliers, paying staff, and expenses like rent and utilities.

Cashflow Management

The trick to good cashflow management is to keep tabs on three things:

1. The amount of money coming into and out of your business
2. Timing - i.e. when money is due to come in and go out
3. Certainty - i.e. knowing that money will be there and balancing up the risk that income might be late or not arrive at all, or expenses may come in earlier or higher than expected.

For your expenses, you also need to be clear about what are fixed and what are variable. ***Fixed costs*** remain the same over a specific period and don't change with the ups and downs of your business, e.g. rent, insurance, loans and other overhead-type expenses. It's all the expenses you have to keep paying even if you didn't make any sales. ***Variable costs*** are ones that are associated with making a sale. The total of these costs increase and decrease depending on your volume of sales.

Remember, business income can be inconsistent. If you're going from a quiet time in the business into a busier time, you'll need to make sure you have enough cash in the business to cover your costs whilst you wait for the new income to flow through.

Watch the full video:
www.manyrivers.org.au

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Interpreting Financial Statements

Sometimes business owners find financial statements confusing, so if you do, you're not alone! The three key statements are Balance Sheet, Profit & Loss and Cashflow:

- The **Balance Sheet** shows where you are at a point in time, i.e. what you own (assets) and what you owe (liabilities)
- The **Profit & Loss** shows the total income your business earned over a trading period, and the expenses incurred to achieve that income. From those figures you can see what net profit or loss you have made over that particular period
- The **Cashflow** statement records the movement of money coming in and out of your bank account

Example:

You've bought a car for your business and the cost of the car was $10,000.

- On your **Cashflow** statement, there will be a $10,000 reduction, as the money has come out of your bank account on the day you purchased the car.
- On your **Balance Sheet**, you have a cash reduction of $10,000, but you'll now have an asset that is valued at $10,000. You expect to be able to use the car in the business for 5 years.
- Your **Profit & Loss** will record a depreciation cost of the car of $2,000 per year, for using the car to generate the income in your business. On your **Balance Sheet**, the asset value of the car would reduce by $2,000 each year, reflecting that the car asset is reducing in value each year as it is being used to generate your income.
- From a practical **cashflow** perspective, every cent of the $10,000 left your bank account on the day you bought the car.

Golden Rules to Managing Cashflow

Some golden rules to managing cashflow:

- **Keep your business and your personal bank accounts separate**

You need to understand how your business is performing as a business. Also, it can be difficult and time-consuming to pick apart personal and business expenses when tax time comes around.

- **Be conservative**

It's always better to assume sales will be lower, customers will be slower to pay and expenses will be higher and earlier than you expect.

- **Set and review expectations**

Cashflow is a crucial business tool. You need to review it and update it every month. Good cashflow management isn't about guesswork; it's about planning and taking specific action.

A successful business has positive cashflow. This happens when:

- The cash amounts coming into the business are greater than the cash going out
- There is enough cash to cover costs on their due date
- Fixed costs can be paid even when business is slow
- There is a high degree of certainty that income and costs will land when expected

Many Rivers has a team of business coaches that can answer your cashflow questions and help you to establish cashflow management that's right for your business, so get in touch and ask for help.