LET'S TALK… CASH FLOW

BY JAMES HARKNESS / EXPERT, FEATURED, LET'S TALK BUSINESS / 14 MAR 2018

Inadequate cash flow has been cited as the cause of two in five business failures in Australia *, lending credence to the age-old saying that 'cash is king' (*an especially unmerciful one at that*).

For this week's *"Let's Talk…"* feature, we asked more than a dozen thought leaders to identify the common mistakes startup founders and other business owners make that kill their cash flow.

Failing to track, forecast and plan for cash flow. Growing too fast. Splurging on 'want to haves'. Doing stuff that adds no value. Overestimating future sales. Hitting a tight spot but not being upfront with suppliers. Taking a

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set-and-forget approach to receivables. Making it difficult for customers to pay. Committing to long-term supply contracts that don't afford flexibility around spend. Not accounting for tax obligations and seasonality. Tying up cash flow in stock. And Paying invoices at any cost… these were just some of the many mistakes identified by this week's commentators.

Read on for further insights from this week's line-up…

Heather Marano, founder & director, Green Door Co: **"**Many businesses aren't properly monitoring or forecasting potential cash flow issues ahead of time. I fell into this trap early in my business. Once my overheads increased, I naively assumed that since I was bringing in enough revenue overall that we were covered. Of course, that wasn't the case. I eventually became unstuck due to a combination of clients not paying their invoices on time, tax and other costs, and was forced to dip into my own funds. This was obviously unsustainable. Now I track and forecast my cash flow religiously. This allows me to make more informed purchase decisions and avoid any cash flow traps."

Sam Allert, Managing Director ANZ at Reckon: "Cash flow is king in business, but like any flow, it can be interrupted. A common and vital mistake many business owners make is poor forecasting of sales mixed with the very real threats of plummeting sales figures. Firstly, to map out and budget your business correctly to ensure profitability means positing a forecast on projected sales figures.

"Overestimating these future sales is a very common issue, often fuelled by eternal optimism for your venture. You need to be making very frugal, minimum forecasts to avoid over-egging your cash flow. Surplus sales are great. Insufficient sales are a budget shredding, cash flow disrupting disaster.

"In a related point, you need to be extremely vigilant of future competitors, government regulation, online giants and customer trends as these can come seemingly out of nowhere to trash an otherwise reasonable sales prediction. So, keep your eye on the market and keep your expected sales in check, erring on the side of

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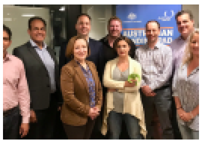

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underestimation. You can easily keep an eye on your net position and forecasted sales using a cloud accounting app."

Mick Spencer, founder & CEO of ONTHEGO: "A common mistake made by business owners is underestimating the importance of having strategic plans for cash flow management. This can be very easy to do in a fast-growing business when there are so many competing interests that require your attention. That's why I think it is really important for business owners to have a really good understanding of their business, its various sales channels and revenue lines. Tying up cash flow in stock is another common mistake that can jeopardise cash flow. Where possible, try to negotiate trading terms with suppliers so that you don't have to use all of your cash flow upfront. Knowing your working capital days and working capital cycle is also very important. Having a strategic plan that forecasts your finances 12 to 18 months in advance along with a team of people who can manage and execute that plan is vital. If you can't measure it, you can't manage it."

Danielle Fletcher, Marketing & Strategy Director at Kimberlin Education and Portfolio CEO, Heads Over Heels: "There has never been a truer saying then "Cash Is King" for a small business owner – keeping a close eye on cash flow is imperative to ensure the ongoing success of your business. As small business owners your hands are often in many pies and a common mistake is taking a set-and-forget mentality to your due receivables. The virtuous feeling you have after sending off all these invoices for the month can quickly turn sour when you forget to double check if your customers have paid on time. A long list of overdue receivables can take a big toll on your cash flow."

Colin Porter, founder & CEO of CreditorWatch: "There is no single magic bullet when it comes to effectively managing cash flow, businesses must take a combination of actions. Some common (and not so common) mistakes for businesses to avoid include:

- *'Surprise':* Neglecting to set aside adequate money to cover pending tax and superannuation obligations
- *'They said they would pay':* Failing to understand who your customers are by performing a credit check (in addition to being affordable and easy to obtain,

this information will help you limit your risk of bad debt).
  - *'Just an invoice is never enough':* Not staying on top of receivables by implementing and following a formal procedure for issuing invoices, statements, final notices and letters to customers."

Ben Pfisterer, Country Manager at Square Australia: "Cash flow problems most commonly arise from businesses that outlay their resources on delivering products and services that they don't get paid for. Rather than customers who never pay up, it is incredibly common to have customers who don't pay within a reasonable timeframe. Late payments, and subsequently chasing late payments, is one of the easiest pathways to a cash flow crisis – especially for smaller businesses or businesses that are just getting off the ground.

"There are many strategies that can be implemented to avoid or minimise this risk, and investing in the right payment tools is a must. The key is making sure you have a convenient and simple way for your customers to pay. Mobile card readers and e-invoicing technology is a good place to start. The rise of DIY cloud-based technologies means that you can turn the smartphone in your pocket into an instant point-of-sale system, which makes taking payments on the spot easier and more affordable than ever."

Adam Joy, CEO of the Australian Lottery and Newsagents' Association (ALNA): "The worst way to manage cash flow is to pay an invoice at any cost, such as accepting credit from payday lenders at exorbitant interest rates. This is fraught with danger because it becomes a cyclical problem.

"It is better to be upfront with the supplier and let them be the sole creditor. You can do this in a couple of ways: negotiating smaller repayments or lengthening your trading terms for the short term.

"Most suppliers prefer the former because it helps their cash flow too. Let the supplier know you've hit a tight spot. If you owe them $1000, negotiate to repay $100 per week for 10 weeks and do not miss a repayment. This will give you time to return to a position where you can manage cash flow without attracting interest and your suppliers are less likely to stop supply or list you as a bad creditor."

Alan Manly, managing director of Group Colleges Australia and author of *The Unlikely Entrepreneur*: "Sales are the driving force for all organisations with sales goals often based on the simple formula of ever increasing sales volumes. However, this drive for turnover can come at the expense of margin. To meet the sales goal, prices are often lowered. The situation is then created that it can be easier to increase sales than it is to raise capital, cash, or to produce the goods or deliver the services. This is when the term cash flow raises its ugly head. Cash earned from the margin in past sales is required to fulfil the outstanding sales orders. Therefore, each sale needs to be cash positive. Less sales with more margin is not always popular but can avoid the most common cash flow mistake."

Gemma Lloyd, co-founder & co-CEO of DCC Jobs: "A common mistake businesses make is not balancing solvency with growth. This is true across the board, as allocating too much spend to one or more area that isn't then covered by income can have a negative effect on cash flow. We found this in determining our marketing spend. To maximise our cash flow, we allocated a percentage of current sales and cross-checked that against current cash flow. We were then able to maintain a manageable marketing budget that we reviewed on an ongoing basis.

"Another common mistake is committing to long-term supply contracts that don't allow you the flexibility of ramping your spend, either up or down based on your current cash flow. If you're locked into a long-term contract at a high rate and your sales drop, you're committed to covering that cost without having the cash in the bank.

One tip that can help with cash flow is to build an annuity revenue model instead of selling "one-off" services. In our case this means opting for a SaaS model, which is a subscription-based billing method, meaning we have a more predictable and easier to manage cash flow."

Samantha Dybac, founder & Managing Director of The PR Hub: "Spending money you don't have on building an 'image' which you think will impress people. Many entrepreneurs tell the story of starting a business from their bedroom or spare room and there is a good reason for this. Cash flow. Every dollar counts and as you move from startup to small business focusing spending on the 'need to haves' not the 'want to haves' shouldn't change. It can be really easy to get carried away with building the best-looking website or creating fancy business cards and an office fit out, but if you don't have the capital then you will soon run into trouble and cause yourself a lot of extra stress."

Jonathan Lui, Founder of Soho: "In startups, a common theme that hurts cash flow is hiring too early and too fast. Delays in launching your product to market are common and during the extra weeks or months that are added to your timeline, salaries will burn significantly more cash reserves. Make sure you are only hiring for roles you really need and at the right time, often you should be doing the work yourself first and then hiring someone to take over these responsibilities.

"Not factoring seasonality into the equation can also jeopardise cash flow and it varies per industry. For example, public holiday periods can be really bad for some businesses whereas others flourish.
New businesses may find themselves underprepared for these fluctuations especially if it is their first year operating."

Greg Bader, CEO of Rent.com.au: "A common mistake is doing stuff that adds no value. As a startup, we have no shortage of great ideas but you need to be very ruthless in prioritising. We attach a business value to everything we do, be it marketing, customer care, design or new products. Translating our thoughts into a common language of $ is a great way to allow passionate people to have input across all business activities, allows for fast decision making and facilitates group accountability.

"The crucial part of this approach is to then measure the performance against that business value. We know daily/weekly how things are performing in terms of their cost and benefit. This works well in helping everyone get better at understanding the business value of an idea and reduces the risk of nasty surprises. It's pretty basic stuff but we find it gives us the courage to reprioritise projects if they are not performing and allows us to actually get things done."

James Coyle, chief customer officer with SuperEd: "In B2B sales, overestimating the speed at which large institutions make decisions and get moving is a very common mistake that could jeopardise cash flow. Another one that some startups or small businesses often make is overestimating the willingness of these larger institutions to innovate and to really test the waters in the market. Finally, a third key mistake is how some small companies get completely swamped by the bureaucracy of bigger institutions. Most big institutions don't relax their protocols for smaller institutions – they put us through the traditional security, data and compliance checks at each point along the way. It happens all the time, even for very small projects and if it's a B2B sale, that's where you can get swamped, particularly if they're major institutions with a lot of legacy infrastructure."

Terry Gold, managing director of Techstars Adelaide: "A common mistake that startups make is to fail to realise that it is possible to go bankrupt by growing too fast.

"There is this notion, particularly among startups, that the faster they make sales, the more successful they are. The problem is that in most businesses costs grow even faster than sales, so the faster you grow the harder it is to make ends meet. Hiring more people, perfecting your product, investing in R&D and moving offices, all are costs that can easily get away from founders. A company that is growing sales but isn't managing how quickly the cash actually flows into the bank is doomed.

"The ingredients for managing cash flow are very simple:

- Decide how far you will plan into the future
- Estimate your sales
- Estimate your costs
- Understand how quickly your customers will pay after you deliver your product.
- Plan when you will pay or receive money."

Mark Fletcher, CEO of Cohort Go : "Cash flow is the lifeblood of any startup or small business, which is exactly why it is vital for businesses to develop a detailed cash-flow forecast from the get go. Many companies don't have a cash-flow forecast, so they have no clear visibility of how their money is trending. The old mantra 'you can't manage what you don't measure' really applies here. In the early stages, expenses are easy to forecast, but not revenue.

"A well-crafted forecast will enable you to identify when cash will come in, when payments will need to be made. Adopting a conservative approach is the safest bet – overestimate expenses and underestimate revenue."

Grace Lin, chief financial officer of Retech: "Cash flow is an important indicator for both the management team and a company's investors to better understand an enterprise's business. But unfortunately sometimes there are instances where a company's performance can be misrepresented and cash flow may not always reflect the true face of a company in its particular phase of growth or development.

"A common mistake that companies make when it comes to cash flow is failing to pay attention to the net income generated from operational activities. All companies have a clear responsibility for outlining both their financing activities and investing activities and failing to do so could harm a company's image when it comes to explaining its cash flow.

"Operating cash flow can also be affected by other factors including accounts receivable, cash received from government subsidies and other items which are not always directly related to the business, but are recognised in standard operational activity. This is why it's important to use the right calculations to ensure you aren't misleading both your investors and the market and to avoid jeopardising your cashflow."

"Sometimes there are inter-company transactions within one group, and when preparing the consolidated cash flow report, the classification of these items are not always clear. This is another common mistake and the definition of these transactions – as either operational or investing ones – could make all the difference when it comes to helping investors to better understand your business."

*http://asic.gov.au/about-asic/media-centre/find-a-media-release/2014-releases/14-254mr-asic-reports-on-corporate-insolvencies-2013-14/

About "Let's Talk…"

"Let's Talk…" is an exciting weekly initiative that provides entrepreneurs and industry experts with a forum to share rapid-fire views on a range of issues that matter to start-ups and SMEs. Every Wednesday, we pose a themed question to a line-up of knowledgeable industry figures, with a view to picking their brains for valuable insights to share with you, our readers.