EBIT Management Services Pty Ltd

Budget/12 Doesn't Equal Cash Flow

By Jon Gillingham, EBIT Management Service

April, that time of the year when the nights appear longer, air is crisp in the morning and getting out of bed is just that little harder.

It's also the time of the year when many business owners start to plan "next year". The success or failure of the current year is nearly over and they are now looking forward to the new financial year with gusto and vibrancy.

To launch the New Year, many commence the annual budget process with plans of increased sales, reduced expenses and improved gross profit margins often being the order of the day.

My issue as an outsider assisting businesses, is the conversion of the budget to a meaningful cash flow. Remembering that cash flow repays debt, meets your employee entitlements, keeps creditors at bay and provides your income.

After the business plan, the cash flow is the next important management tool. Many see the cash flow as the reality test to what they want to achieve in the coming year. Importantly, it is a measure of the financial strength, or lack of financial strength, to the business.

Here are the five areas that I often see issues with:

1. Opening or beginning cash balance is absolutely crucial. It has to be clear where the business is starting from. If you have an existing business, adopt the closing balance (estimate if undertaking in April) from the year ending. For a new business what is the cash or capital that you actually have in hand.

2. The fixed operating costs what are they? When do they fall due? Most will fall in a calendar month such as rent and wages, but be mindful of one off items including insurances and statutory payments that you may not be able to amortise, these need to be shown in the month they fall due.

3. Your terms of trade being Accounts Receivable arrangements, invoices unfortunately will not be paid within the due date. So when looking at your sales income, factor in a percentage each month that is likely to be collected i.e. 70% and carry forward the other 30% or less into the next pursuing months. Some businesses have scaled their receipts 60%, 30% 10% over a three month period as historically that's what has occurred.

4. Suppliers terms of trade being Accounts Payable can vary from C.O.D (Cash on delivery) to payment terms over 30, 60, 90 days or more, again payments should be factored over the term of trade. Some businesses offer a discount i.e. 2.5% if the invoice is paid prior, this should be seriously considered.

5. Understand your funding needs. If there is a deficiency between cash in (income) and cash out (expenses) how is that going to be funded, perhaps bank overdraft or capital set aside. Remember here that short term loans should be for a short term.

Cash flows as mentioned before, is a reality test as to what you are setting out to achieve. That said they are not fixed in concrete, they need to be flexible as challenges or win falls in your business will be experienced.

My last suggestion when making assumptions and budgets, remember a budget divided by twelve is not a cash flow.

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