GOVERNMENT OF WESTERN AUSTRALIA

Department of Primary Industries and Regional Development

*We're working for Western Australia.*

# Cash flow management

The Investor Readiness Program is an initiative of the Department of Primary Industries and Regional Development delivered in collaboration with BDO Australia.

# Contents

# What is **cash flow?**

Cash flow management is the most important aspect of every business. A healthy cash flow ensures that the business can pay expenses on time and have funds for growth and expansion of the business.

Cash flow is the term used to describe the money that is moving (flowing) in and out of your business within the month.

## Cash in

Cash is coming in from your customers or clients who are buying your products or services. If customers do not pay at the time of purchase, some of your cash flow will then be coming from the collection of your trade receivables.

## Cash out

Cash is going out of your business in the form of payment of expenses like rent, interest, salaries and wages, the payment of taxes and accounts payable. Cash going out can also be in the form of purchasing investment assets.

## Cash flow statement

In order to keep track of and effectively manage cash flow, you will need to understand and create a cash flow statement. A cash flow statement provides information about your cash receipts and payment during a period. A cash flow statement differs from a profit and loss statement, as the profit and loss statement will show the revenue you have earned rather than the physical cash collected.

# Types of **cash flow**

Cash flow is classified in three different categories.

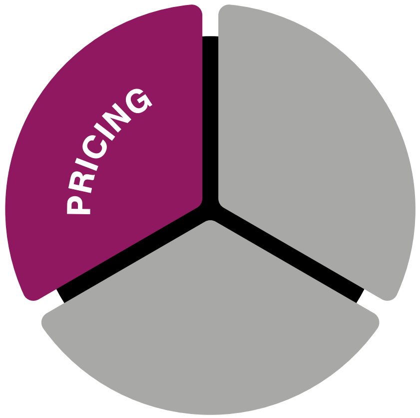
| | | | |
|---|---|---|---|
| **OPERATING ACTIVITIES** | The cash flow generated from operating activities is termed operating cash flow. Operating activities include your businesses day-to-day activities and are related to net income. | Cash receipts from:<br>• sale of goods or services<br>• dividends from investments. | Cash payments from:<br>• employee payroll<br>• income taxes<br>• interest paid to lenders. |
| **INVESTING ACTIVITIES** | Investing activities include cash activities related to non-current assets. Non-current assets include long term investments, plant and equipment, and the principal amount of loans made to other entities. | Cash receipts from:<br>• sale of long-term investments<br>• sale of property, plant and equipment<br>• collection of principal for loans made to other entities. | Cash payments from:<br>• purchase of long-term investments<br>• purchase of property, plant and equipment<br>• loans made to other entities. |
| **FINANCING ACTIVITIES** | Financing activities include cash activities related to non-current liabilities and owners' equity. Non-current liabilities and owners' equity items include the principal amount of long-term debt, share sales and repurchases and dividend payments. | Cash receipts from:<br>• issuance of notes<br>• issuance of bonds<br>• issuance of common shares. | Cash payments from:<br>• principal amount of loans<br>• repurchase of common shares<br>• cash dividends. |

# Cash flow strategies

There are three strategies to improve the cash flowing into a business and four strategies to reduce the amount of cash flowing out of a business.

## Cash inflow strategies

### Pricing




1. **Increase prices**
   When deciding on the price of the service or product, a business must understand their customer.

   Understanding why a customer is buying a product or service influences the perceived value and therefore the price they are willing to pay.

   To maximise cash flow, businesses should conduct a review of their pricing to determine whether the price aligns with the perceived value of this offering. If the value of the product is higher than the price, then the price should be increased.

   *Tip: When setting prices, focus on the value provided rather than profit margin of a product or service.*

2. **Focus on profitable customers, products and or services**
   A business will have some customers that are more profitable than others.

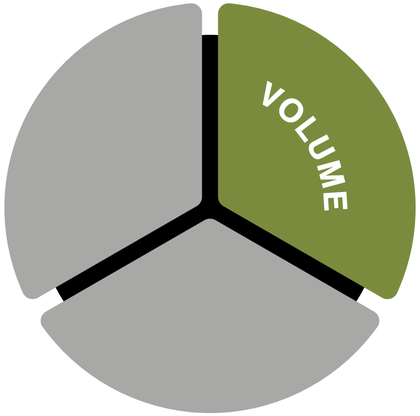
   In order to improve cash flows, businesses should identify the least profitable customers to determine whether they should continue the relationship. You should do this also for the least profitable product lines and/or services. By identifying and dealing with the least profitable elements of your business, you will gain time and energy to put towards the more profitable customers, products and/or services.

3. **Increase the value you deliver**
   Consider customers needs and determine how to address their needs.

   To provide the highest contribution, a business must address the critical needs of their customer. Customers are likely to pay more for services that address their key issues which in turn will increase your cash flow. Some key actions you can implement to transform to a more value focused business are:

   - focus relentlessly on understanding and addressing your client's real needs
   - grow your value by offering solutions to your client's issues
   - deliver quality products and services efficiently.

## Volume




1. **Increase the number of potential customers**
   It is always easiest to sell to your existing customers, as an existing customer is already, to some degree, loyal to your product or service. New customers are yet to develop loyalty, therefore, more effort is required to get them to this stage.

   If you are focusing on increasing the number of potential customers, you will need to identify who these potential customers are. Once identified, you can develop and implement a marketing plan of how they will go from potential customers to profitable customers.

2. **Increase products and or services**
   Increasing the volume of overall sales will immediately affect cash flow. The easiest way to achieve this is to develop a new offering with increased potential for recurring revenue.

   By increasing your products or services, your sales team can now promote new products to your existing customer base. The ideal result being additional revenue without the increased cost of additional sales employees.

3. **Sell into a new market or territory**
   Have you exhausted your existing market? If so, you may want to consider a new market or territory. If you are going to sell into a new market or territory, you need to research and understand the potential new market. In order to be successful, you want to ensure this new market aligns with your strategy.

   Some considerations when selling into a new market:

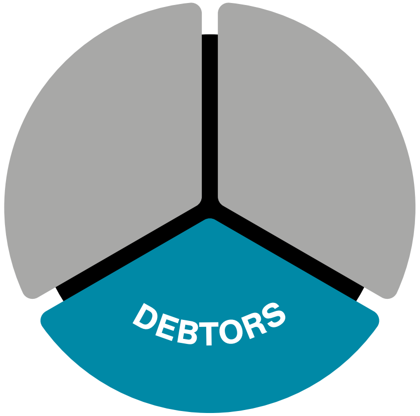
   - **Research** - Before you start selling into a new market, research the market to understand it. You will need to understand the real issues and underlying motivations of your new target customers.
   - **Relationships** – You will need to develop and implement a marketing plan before you can expect your product or service to gain acceptance in a new market. Focus on your credibility and developing relationships, as people generally do business with those they trust.
   - **Target customers** – In order to make this process easier and expand your product, identify who your ideal customers are and target your marketing to these ideal customers.

4. **Improve the sales process**
   By improving your sales process, your sales team will become more efficient, which in turn will mean higher revenue from increased volume.

   In order to make your sales team efficient you need to create a sales strategy that your team can follow. Without planning, you are unable to manage all parts of the sales process.

   Consider investing in a Customer Relationship Management (CRM) system to capture details of clients, contacts, leads and opportunities. CRM software helps you collect meaningful data to analyse your sales, customer base and identify emerging trends.

## Debtors




An efficient way to improve your businesses' cash flow is to work with your debtors to negotiate earlier payment. It is important that you make your payment options clear whilst offering a variety of payment options such as cash, credit, bank deposits and BPAY.

Whilst there is no single solution to payment terms as each transaction is different, 30-day invoices are becoming a thing of the past. Consider whether 7, 10 or 14-day terms of payment would suit some of your business engagements.

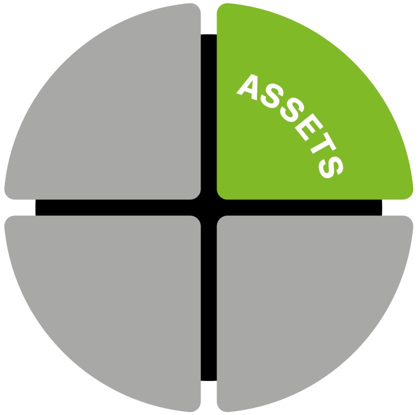
Other terms of invoicing debtors include:

- Cash on delivery (COD).
- Payment before the engagement begins. This can be through deposit or part payment when ordering.
- Interim billing – Asking for progressive payments over the course of a longer job.
- Encourage early payment – Offering a discount for early payment or charge interest for late payments. Follow up your debtors frequently.

***"An efficient way to improve your businesses cash flow is to work with your debtors to negotiate earlier payment."***

## Cash outflow strategies

### Assets




1. **Sell underutilised assets**
   Consider which assets can be converted into cash to increase cash flow. Does your business have any underutilised or surplus assets that can be sold in order to distribute the capital back into the business?

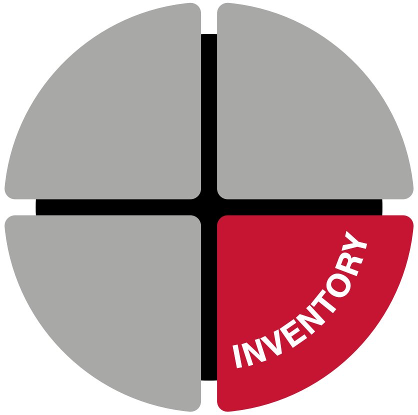
   Consider reviewing your asset register to determine which assets are underutilised and could be sold.

2. **Consider refinancing**
   The ongoing strain of loan repayments and interest payments on the cash flow can cause issues in the day to day running of the business. In order to maximise cash flow, you could review the current loans that your business has to see if they can be refinanced at a lower interest rate.

3. **Sale and lease back**
   The process of a sale and lease back transaction is where a business sells an asset, often real estate or equipment and then enters an agreement to lease it back. The advantage is that it enables you to redeploy the capital that was previously invested in the asset back into the core business. The money can then be used to:

   - reduce debt
   - reduce the amount of interest paid on borrowings
   - create cash liquidity for expansion or investment in plant and equipment
   - provide ongoing working capital.

### Inventory




1. **Reduce cost of stock or materials**
   There is a direct link between a business's cash flow and its inventory stock or materials.

   As a business, your goal should be to reduce the cost of materials without hindering the final product produced.

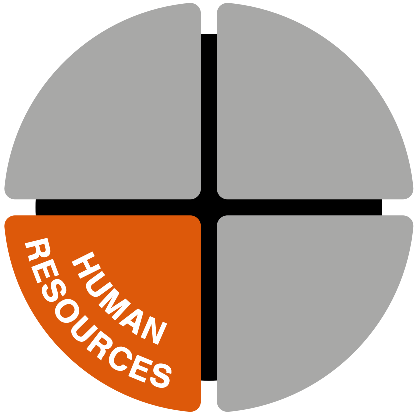
   To do this you may want to consider new suppliers who are more cost effective or you may want to negotiate a price reduction from your current suppliers.

2. **Improve terms with suppliers**
   In order to decrease your cash outlay, you should be looking to increase days in accounts payable and negotiate better payment terms with suppliers in order to reduce the amount of cash tied up in unsold or purchased inventory.

3. **Clear obsolete and slow-moving stock**
   As part of your inventory controls your business will need to identify stock levels and clear obsolete or slow-moving stock usually by offering discounts, free delivery or other attractive terms.

4. **Review/change ordering processes**
   Your inventory generates cash flow when the finished products are sold, however, purchasing inventory requires a cash outlay that affects your business's cash balance. If your business model allows you might consider implementing a just in time inventory system which means you receive goods only as they are needed in the production process.

## Human resources

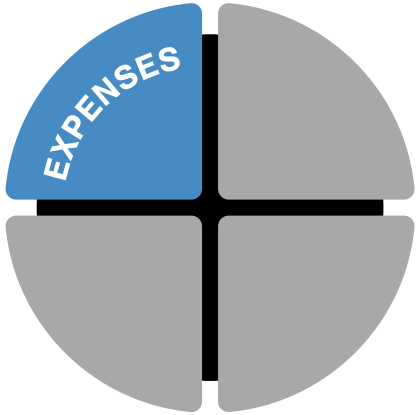



It is important to have the correct team to enable the growth of the business; however, you must take into consideration the cash flow of the business when employing staff. In most businesses, human resources are one of the largest outlays, therefore, you want to ensure when you are hiring that you are doing so with the plan to improve revenue and cash flow.

If your human resources costs are placing an unnecessary strain on your cash flow and you would like to improve it, there are a few areas you can review and focus on, including assessing staff:

- skills to meet needs of the business
- utilisation and efficiency
- flexibility to manage peaks in demand
- turnover which can be reduced by improving business processes and developing a positive culture.

## Expenses




1. **Reduce discretionary spending**
   Delaying spending on non-essential items and services, that offer limited value. If you are unable to defer some expenses an option is to negotiate better terms with supplies. When forecasting in your business plan you should list non-essential expenses that can be eliminated or reduced to free up cash flow.

2. **Reduce your overheads**
   Diminishing overheads will immediately reduce your business cash outflows. This can be done by scrutinising your current operating expenses and considering lower cost options that will not reduce the value of your product or brand in the eyes of your customers. Examples include:

   - utilities
   - software subscriptions
   - insurance policies
   - rent or lease plans.

## The Department of Primary Industries and Regional Development is ready to assist you

For further information please contact:
**e** investorreadiness@dpird.wa.gov.au
**p** 1300 374 731 (1300 DPIRD1)
**w** dpird.wa.gov.au/investorreadiness



424/21