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Five steps to make cash flow management less daunting

Mary Teresa Bitti | October 29, 2014 8:00 AM ET

Fotolia Managing cash flow effectively comes down to having a clear understanding of the numbers and accurately projecting future sales and expenses to maintain operations, fund growth and build personal wealth.

To small business owners who are focused on getting their product/service out to the world, cash flow management sounds like a chore. But it is one that is absolutely essential to get right particularly as a growing small business, says Brad Cherniak, partner at Toronto-based Sapient Capital Partners, a business advisory firm.

“Whereas in big companies cash flow management is an administrative task tied to efficiency, in smaller businesses it’s tied to liquidity and survival. The distinction and the context is important because smaller companies don’t have excess cash on their balance sheet and cash is the lifeblood of any business,” he says.

Cash flow is the amount of cash coming into and going out of a company. Managing it effectively comes down to having a clear understanding of those numbers and accurately projecting future sales and expenses to maintain operations, fund growth and build personal wealth.

In many ways, managing cash flow is all about learning from how things change to be better able to predict what’s going to happen next. “The key is to bring as much insight into the process to anticipate the future, which is always the hardest thing to do,” Mr. Cherniak says.

“For small businesses, cash flow management directly drives the value of your company. Your ability to show that you can effectively forecast cash flow and that you have the discipline to track cash flow daily, weekly or monthly is very important for investors.”

If you are finding setting up an effective cash flow management strategy daunting, here are some steps to help you get started:

Cash flow is not always going to positive — and in some cases, that’s OK “When companies are growing and transitioning, they can have negative cash flow, which can mean one of two things: there is a problem in the business or you are investing for the future,” Mr. Cherniak says. “It can be hard to tell those two apart in today’s technology driven environment. One of the keys to manage that is to get a handle on the totality of your business today — products, employees, facilities, cost base — and how you expect cash flow to change.

Forecasting is key “Track inflows and outflows and create some averages,” says Bruce Morrison, portfolio manager of Calgary-based Morrison & Partners Wealth Strategies. “Build in growth expectations and what type of investment will be necessary to get you there. The goal is to grow revenue without adding expenses — that’s the magic formula. For example, in my business, I’ve spent so much time building processes, infrastructure and staff that I can now scale the business without incurring additional expenses.”

Create the context Start with the longer-term forecast — one to two years. “That’s the conceptual framework. It’s not a control mechanism,” Mr. Cherniak says. “To get control, you want to track cash flow monthly, weekly or even daily, depending on the type of business and its stage of development. This is very streamlined — a cash in/cash out tally. The important thing is you are anticipating how cash flows are going to change and seeing how you do relative to expectations. Tracking cash flow in this way will allow you to create a reasonable set of projections for the future."

Set up a three- to four-month emergency cash reserve "This is similar to personal financial planning," Mr. Morrison says. "Have money set aside to cover all expenses should something unforeseen happen. You can put the money into something liquid that doesn't have any volatility, such as T-bills or high yield savings accounts. A cash flow strategy helps you prepare for the ups and downs of business cycles."

The more aggressive the growth, the more important it is to stay on top of cash flow "Whoever is tasked with financial management has to be aware of what's going on in the company and how it performs quarterly, semi annually and annually," Mr. Cherniak says. "If you are adding new products or expanding geographically, for example, it's critical to step up the game and have an independent perspective. That's where boards, advisory boards or mentors canbring a fresh set of eyes to how you're managing cash flow to spot potential problems early and course correct or to confirm that things are fine."