vha accounting
SOLUTIONS

# *Grasping the* BASICS OF HEALTHY CASH FLOW

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DISCOVER YOUR FULL FINANCIAL POTENTIAL

# Grasping the Basics of Healthy Cash Flow

## Is there a market for your product or service?

Do potential customers exist within this market, and can you effectively reach and sell to them?

Does your business or service solve a meaningful problem?

Are you selling enough at the right price?

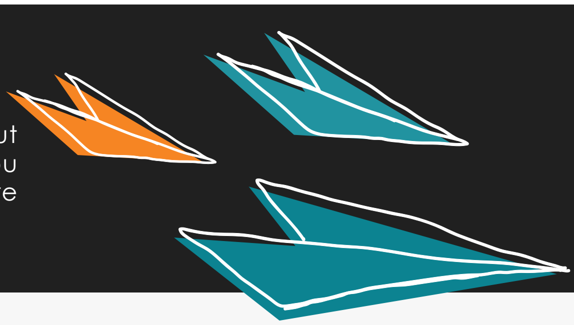
Is your profit margin sufficient to cover your overheads multiple times?

After sales, do you generate a profit margin?

If your business is facing cash flow issues, it's not truly a cash flow problem—it's a problem with how the business is managed. Without customers, there is no business. Customers only buy when they have a real need, and your product or service must address a specific problem for them. For your business to thrive, there must be demand for your offering in the marketplace.

## The Significance of Volume

Selling a few products or services might sustain you temporarily, but you need volume for your business to be profitable in the long run. You must scale, reaching a larger audience with your offering to ensure economic viability.



## Setting the Right Price

Once you've confirmed there is a market and willing buyers, the next step is to price your product or service appropriately. An unstructured pricing approach can result in zero profit and negative cash flow. Often, entrepreneurs neglect proper pricing. A common misconception is that pricing too high will drive away customers. Instead, focus on how your product or service solves the customer’s needs.

## Understanding Margins

With your marketing strategy in place and sales occurring at the correct price, it’s time to assess whether you're generating enough revenue to achieve a healthy margin. A margin is the difference between the price at which you sell your product or service and the costs directly associated with creating, purchasing, or delivering it.

## Managing Overheads

To earn money, you need to spend money. This is where overheads come into play—expenses such as rent, telecommunications, cloud subscriptions, and marketing costs are vital to running your business. However, if your overhead costs exceed your profit margins, your business will operate at a loss. Ideally, you want to generate enough profit to cover your overheads several times over. The goal is to have the highest possible margin, which gives you a cushion to comfortably cover your business expenses. If your business is not set up for this, long-term survival becomes questionable.

## Turning Margin Into Cash Flow

The next step is to convert your profits into cash as quickly and smoothly as possible. Ideally, you want customers to pay immediately after you invoice them.

# Recognizing the Warning Signs of Trouble in Your Business

### How can you tell when your business is in trouble?

There are several clear signs that indicate your business may be heading in the wrong direction. It's important to note that while cash flow is often a major concern, many other issues within your business can ultimately affect cash flow if not properly addressed. If you're already facing financial difficulties, or if you want to proactively avoid them, it's crucial to watch for these red flags:

### Losing Existing Customers

If you're losing customers, it's time for some serious reflection. Why are customers leaving? It could be that your product or service no longer meets the original promise or solves the problem it was intended to. Regular quality control and ongoing assessment of your offering are vital to maintaining customer loyalty.

### Struggling to Attract New Customers

Failing to bring in new customers is often linked to losing existing ones. Sometimes businesses reach a point where they stop focusing on growth, assuming they've reached their maximum capacity. However, this mindset can be risky.

New customers are essential not only for increasing margins but also for bringing fresh ideas and insights. These can help you reassess your value proposition and ensure it remains relevant.

### No Profits

It may seem obvious, but many business owners are unaware of whether they are actually turning a profit. It's crucial to keep your financial records up to date, so you can confidently say whether you're making a profit or not.

Key questions to consider include:

- Are you pricing your products correctly?
- Are you selling enough volume?
- Does your profit margin cover your overheads multiple times?
- Are there unnecessary costs eating into your profits?

A good practice is to regularly review your overheads, at least once every quarter or every six months, to ensure that your spending is efficient and justified.

### Late Payments from Customers

Are your customers paying you on time—or at all? If they're not, you're likely caught in a negative cash flow cycle. Here are some basic rules to follow:

- Stop selling to customers who haven't paid for past purchases until they settle their debts.
- If a customer consistently pays late, insist on upfront payments in the future.
- Establish a solid credit control system to manage and follow up on overdue invoices.
- Leverage technology to automate debt collection and reduce manual effort in chasing payments.

### Not Paying Suppliers on Time

Are you consistently late in paying your suppliers, or are you constantly scrambling to find the funds to cover those payments? This is another warning sign that should not be ignored.

### Inability to Pay Yourself a Market-Related Salary

As a business owner, are you paying yourself a reasonable salary? If your business is profitable but your salary is not included in your overheads, then your business isn't truly profitable. Your salary should be factored into your operational costs. If you aren't paying yourself a market-appropriate wage, it could be a sign that your financial structure needs to be re-evaluated.

## Should you consider borrowing money?

Borrowing money can always be a good option for your business for a few key reasons:

### It Provides Leverage

As a business owner, you're taking on significant risk when starting and running a business. There's always the possibility that things won't work out, and if they don't, you could lose everything you've invested. So, if you can secure external funding to help share this risk, it gives you leverage by spreading that responsibility. This leverage is crucial, which is why it's always worth considering borrowing money – it allows you to share the financial burden and reduce your personal exposure.

### It's More Cost-Effective

In many cases, borrowing money is more affordable than using your own capital.

Putting in your own money means you're expecting a significant return, as you're risking your own funds.

However, if you borrow money from a third party, they typically take on much less risk, and as a result, their expected return is much lower. This approach not only spreads your risk but also lowers the cost of funding.

### It's Always a Good Time, Unless It's Not

Create a budget and a forecast to project your cash flow and determine how much capital you'll need. This will give you a clearer picture of your cash burn rate and the runway you need to operate. With this information, you can approach a lender with a solid understanding of why you need funding and how it fits into your business's future goals, rather than just borrowing money impulsively due to cash flow issues.

### Finance for Growth

A great reason to apply for additional capital is when you need it to finance an investment that will drive growth—such as purchasing new machinery or a vehicle. These are typically long-term investments that can benefit your business, while you might prefer to use your own funds for day-to-day working capital.

However, securing funding is not always easy, and third-party lenders will conduct thorough checks on your business's financial health. If you're facing challenges, it will be difficult to secure funding until your situation improves.

### In Summary

Before seeking external funding, ensure your business fundamentals are sound, and you understand where your cash flow issues are coming from. Once you've identified the internal steps needed to improve, you can confidently pursue financing options, whether it's for business growth or addressing temporary cash flow gaps.

# Can you draw a salary from your business?

As a business owner, determining when and how much to pay yourself is a critical decision. It's important to factor in your salary as part of the business's overheads since your time and efforts are directly contributing to the company's operations.

### In the Beginning, You May Need to Work for Free

Unless you have external investors, you'll likely need to invest your money into your business. This is essential in the early stages to get the business off the ground, attract customers, and generate cash flow.

Once you're past the initial phase, you'll have two main forms of compensation:

1. **Salary**

   This is the basic payment for the work you're doing in the business. Whether you're handling sales, marketing, or day-to-day operations, your salary compensates you for the time and effort you put in.

2. **Profit Share:**

   Once your business is profitable, and you've covered all overheads (including your salary), the remaining profit is your reward for taking the risk of owning a business.

It's crucial to distinguish between salary and profit, as they represent different forms of compensation. If you don't make this distinction, you might misinterpret your business's performance, leading to poor decision-making and unrealistic expectations about its value.

### Determining Your Salary

The first thing to consider is whether there is cash available in the business. If there's no cash flow, paying yourself is impossible. Once cash flow is established, the next step is determining the minimum monthly amount you need to cover your personal expenses. This should be a modest figure—what's necessary for basic living costs, not a lavish lifestyle.

### Market Value

Paying yourself a market related salary is ideal but it could put strain on your business. Iit's important to find ways to scale the business quickly—whether through automation, streamlining processes, or hiring someone at a lower level so you can focus on higher-value activities that justify a higher salary.

### Long-Term Strategy: Moving Toward Passive Income

A sound strategy for any business owner is to eventually reach a point where you don't rely on the business to pay your salary. In this ideal scenario, the business can run independently of your day-to-day involvement. This would allow you to generate passive income, which is the ultimate goal for many entrepreneurs. Over time, this passive income should not only replace your salary but also provide you with additional profits as a well-deserved reward for the risks you've taken in building your business.

A lot of business owners get attached to their business, understandably so! However, the biggest sign of success is being able to have your business run without you. Some of the biggest companies in the world attest to this!

## Is the price actually right?

How should I determine the price of my product or service to ensure profitability?

To set an effective price, there are two key factors you need to consider:

### Cost

The first factor to address is cost.

In simple terms, you must know how much it costs to provide your product or service. If you're selling a product, you need to calculate the full cost of acquiring and delivering it to your customer in a way that meets their expectations and fulfills the value promise you made. If you're producing the product, you must know the cost of manufacturing one unit that aligns with your value proposition.

For services, you need to determine how much it costs per hour to deliver the service, either by you or your employees, ensuring that it meets customer expectations and fulfills the service promise made at the start.

Once you know your cost, the next step is to generate a profit margin, which is the difference between the price at which you sell the product or service and the cost to produce or acquire it. However, margin alone isn't enough. You need to factor in your overheads—expenses like rent, utilities, and salaries.

### Value

The second, more challenging factor in pricing is the value you offer to your customers. Determining value requires an understanding of psychology and consumer behavior. The concept of "willing buyer, willing seller" plays a crucial role here. As long as the buyer agrees to the price, you can theoretically sell your product or service at any price, regardless of what it costs to produce it.

Remember when Prime was being sold at R300 a bottle? Demand was high but supply was scarce. Checkers monopolised the market and now Prime goes for R30 a bottle! Demand and supply plays a huge role. For common services, you can set your business apart by offering quality services or goods. Customers value reliability and consistency more than you'd think!

## Cash flow is essential!

How can I reduce the gap between profit and available cash?

Profit and cash flow aren't always the same.

Understanding the difference between profit and cash flow is key. Profit turns into cash but there is a time lag (unfortunately).

Cash is needed to continue operations, so let's think about how we can try and secure cash for the business.

### Sell Effectively

Once a sale is made, it's essential that it turns into an invoice in the customer's hands right away. If immediate payment isn't feasible, request deposits wherever possible. The same money today is worth more than tomorrow, so prioritise collections. Where possible, offer incentives to clients for full payments or payments within terms.

### Manage Supplier Payments

It's equally important to understand your supplier payment terms. If your suppliers demand payment every 30 days but your customers pay you in 60 days, this can seriously strain your cash flow. To avoid this, prioritize collecting payments from your customers before paying your suppliers.

### Plan, plan and plan!

Once you've established these core principles, having a budget and a cash flow forecast is crucial. Track how your cash flow fluctuates from month to month. A well-planned forecast will help you predict cash flow dips and put strategies in place, such as adjusting payment terms or seeking external funding, to cover low-income periods.

## Growth: Balancing Cost Control and Investment

How do you strike the right balance between managing costs and investing in growth?

If your business isn't attracting new customers or increasing its sales volume, it risks stagnating.

Setting clear and consistent growth objectives is crucial to ensure your business keeps moving forward and progressing. In a previous section, we discussed the need to invest money in order to make money. From day one, you must establish your overheads before you start making sales, which is why concepts like "breakeven" are vital.

### Keep Overheads as Low as Possible

Always aim to keep overhead costs to a minimum. However, once your business is profitable, you'll need to decide when it's the right time to increase those overheads in order to support growth.

### Growing Your Business

Your growth strategy should reflect how large you want your business to become and the speed at which you want to grow. It's unrealistic to expect a jump from 50 units to 500 units in a single year. Instead, scale your business gradually.

### Don't Eat All Your Profit! Reinvest

Timing is key. The profit you earn after covering your overheads will be the source of your reinvestment. Rather than pocketing all the profits, you need to allocate some of that profit to increasing your overheads and scaling up your sales. This means sacrificing personal rewards for the sake of business growth. The goal is to use your profits to fuel expansion, even if it means postponing some immediate luxuries.