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How to do a **Cash Flow Analysis**

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Introduction

There are certain times in business, when a business needs a full and **Complete Cash Flow Analysis**.

This guide will help you understand the **importance of a good cash flow analysis**.

It will **lead you step-by-step** through the main points of the analysis. You will end up better understanding your cash flow position. And, as a result, you will be able to better manage your business.

Calxa Team

Why you need to do a Cash Flow Analysis

To keep your business strong and sustainable, you want to understand your cash position. Knowing the makeup of your **inflows and outflows** gives you the upper hand to make some really good decisions around:

- Controlling the day-to-day fluctuations
- Getting a picture of where your organisation is going
- Making confident business decisions

WHEN TO ANALYSE CASH FLOW

When do you need a Cash Flow Analysis?

Growing the business is exciting. It is also a time to be armed with the necessary information to make those important decisions. There are typically, a few **scenarios when businesses need to be cash flow aware**.

Planning for Growth

- Building up a specialist team
- Purchasing new equipment
- Stocking up on extra inventory
- Funding a specific project

Whatever it is, it will affect your cash at bank and requires a solid calculation and an ongoing watch.

Applying for a Bank Loan

A business may look for external finance as a natural next step. A business loan application wants a methodical approach and should take into consideration the needs of the Financial Institution. **Risk management** is at the top of the list for any Bank Manager. So, keep this at the forefront of your mind.

- Offer cash flow information to your bank during your negotiations. It will emphasise how well you know your business and that you're all over those plans.
- Complete a thorough cash flow analysis. This puts the knowledge at your disposal to answer any questions coming your way.
- This will create a very high level of confidence in you from the lender. It may also result in your ability to negotiate a better deal with lower borrowing costs or other obligations connected to any loan.

Providing a Profit & Loss budget and a Balance Sheet forecast with the cash flow forecast shows good financial practice. It demonstrates to the finance institution that you have taken the necessary steps in managing their risk.

Managing a Cash Flow Crisis

It can take just a few months of slow sales, unexpected expenses or just one bad decision to unbalance the scales. These are the times when being cash flow vigilant is appropriate.

You will need not only a good cash flow projection, but it is paramount to understand what influences the cash position.

Even during the good times, the bad times often are not far away.

Know the shortfall

so you can mitigate the problem.

CHECKLIST

Cash Flow Analysis

We've talked about the 'Why' and the 'When', now it's time for the 'How'.

Follow this **5-point checklist** and you will be on your way to understanding your cash position.

1. Cash Flow Forecast

Your Cash Flow Forecast will be your main guide as it shows what your bank balance is likely to be at the end of this month, next month and, ideally, up to 12 months ahead. To build a Cash Flow Forecast, start with:

1. A Profit & Loss Budget
2. Add a Balance Sheet Budget
3. Then adjust timing on everything

For example:

You might budget for sales of $10,000 but if you sell on account to your customers, you'll receive this in the following month (or more likely a spread from the current month to the next 2-3 months). And you'll actually receive that amount plus GST/VAT – so your Balance Sheet budget should factor in changes to your debtors (Accounts Receivable) and your tax liability.

2. Debtor Days

Calculating your average outstanding debtor days is a good way to monitor how good your collections are. The formula to calculate it is

Trade Debtors * 365 /

(Non-Cash) Income

for last 12 months

- Monitor this over time
- Work to lower the number (seek advice if it starts to creep up)
- Compare your result with others in your industry - see whether you are doing better or worse than others

3. Creditor Days

Similarly, watching your average outstanding creditor days will give you advance warning that you are approaching a cashflow crunch. To calculate this, use:

Trade Creditors * 365 /

(Non-Cash) Expenses

& Cost of Sales

for last 12 months

- Your bank balance may be looking healthy because you've slowed down payments to your suppliers. Be aware of this and don't let it get out of hand.
- While delayed payments can help your cash flow in the short term, they can damage supplier relationships in the long term.

4. Working Capital Ratio

This is your Current Assets (things you own that you can convert to cash easily) divided by your Current Liabilities (what you owe that needs to be paid within the next 12 months).

Generally, you want a ratio of greater than 100%.

- Anything less than 100% is a leading indicator that you are in danger of not being able to pay your bills.
- If your ratio is declining it suggests you're having difficulty paying your bills.

Ask yourself:

- Are you making a profit?
- Is too much cash tied up in inventory?
- Do you need longer-term finance?

5. Net Worth Chart

This is a simple chart that shows the components of your balance sheet. Typically, there are 2 bars each month, one for the Total Assets, one for the Total Liabilities, with a line to show your Net Equity (the difference between the first 2).

Ideally you want to see your

Net Equity increase over time.

- For this to happen, Assets need to grow faster than Liabilities
- It doesn't generally matter if both grow
- It's the rate of growth that's important

For example:

If you borrow money *(increase in Liabilities)* to purchase stock or equipment *(increase in Assets)*, that should make your business more profitable and the Net Equity will grow from there.

It's fairly easy to get the numbers for this chart from your accounting system for past periods but you'll need your Balance Sheet forecast to include future periods.

CONCLUSION

Final Words...

So, now you know 'Why' and 'When' it is important to do a Cash Flow Analysis. And, most importantly you know 'How' to do a thorough Cash Flow Analysis.

Now, it's a matter of practising this to get well versed at analysing your cash position. **Make this part of your monthly business review**, and you will get familiar with the process in no time.

Whatever you do, get started with cash flow analysis and help your business grow to stay sustainable into the future.

About Calxa

Calxa saves time for Businesses, Not-For-Profits and Accountants by automating budgeting, cash flow forecasting and KPIs, intelligently.

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Calxa customers receive their Cash Flow Forecast in their inbox and review their cash position on a regular basis.

They all have one thing in common:

They are sustainable businesses that keep themselves strong by keeping their finger on the pulse!

You may want to join them.