

Magic Workbooks
Business Survival Manual

Cash Management

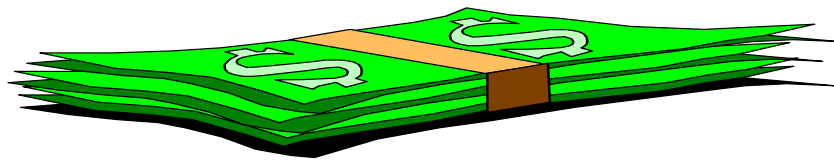
or:

Money's Too Tight to Mention

Let's say you have a neat 15 % profit margin but your bank account balance shows a distinct tendency towards the dark side of zero.

The good news first: this sort of thing is not unusual; bankruptcy courts all over the world are perfectly familiar with this phenomenon.

And now the bad news: unless you start learning about the Art of Cash Management, you might end your business career in a bankruptcy court, too.



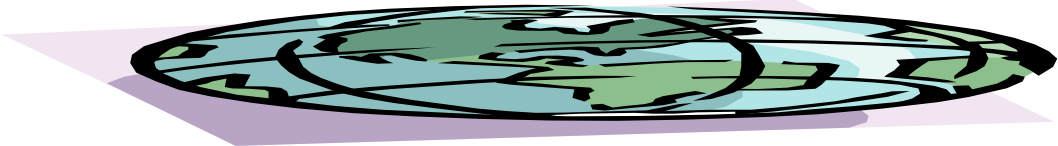
First of all, we need to clear up a common misunderstanding: the term cash management covers two quite different activities, on the one hand the services of your bank in managing your accounts including such nifty timesavers as online banking, and on the other hand the art of making ends meet money-wise.

That is the type of cash management we are concerned with here. Simply put, it is the art or technique of balancing your out-payments with your in-payments. Unfortunately that is a lot easier said than done: if your customers are accustomed to taking 90 days until they pay you that will probably not give you the option of taking 90 days to pay all your outstanding bills!

Most companies today – no matter how small their controlling department – prepare a budget for the upcoming business year. Very few prepare something that might be termed a “cash budget”. Usually, there is some gimmick like one line at the bottom of the budget-sheet for “cash investments” which is supposed to take care of the difference between profit & loss accounts and cash expenditure. Many companies also keep a watchful eye on their Accounts Receivable. But it is seldom indeed that these isolated instances of cash-relevant developments are bundled into a coherent whole, namely a cash budget.

If you start investigating this, the usual comments are that a cash budget is a very complicated affair because you have to “translate” every single item from your budget in terms of in-payment or out-payment and add a specific date to it – truly a monstrous effort. And every single change in your budget has to undergo that same translation process to keep the cash budget up to date. And that is merely the beginning: in the course of the business-year you need a constant alignment of your cash budget with your actual cash reserves – just as your monthly reporting combines actual figures with future budget figures to produce a year-end projection.

In sum, the general opinion is that a cash budget requires EITHER the same amount of work as the profit & loss budget, thus doubling the necessary controlling manpower OR one of those really sophisticated and costly cash management programs which needs constant data input and revision, thus again doubling the necessary controlling manpower.



And of course, the earth is flat and if you travel to foreign shores you have to watch out so as not to drop off the edge ...

OK, let's leave the Middle Ages behind us and tackle the problem in front of us.

The first part of the problem is this: How can we translate a company budget into a cash budget without too much work and at low cost?

The second part is this: how can we "update" the cash budget into an accurate year-end projection in the course of the year, again without too much work and at low cost?

1. Building your own Cash Budget

In order to revamp our business plan or normal budget into a cash budget, we need to clear up two major questions:

- a) what? – meaning, **what** profit/loss account item corresponds to what cash item? and
- b) when? – meaning, **when** does that item become a payment?

WHAT ?	Profit / Loss Account	+ cash relevant items	Inpayment
	Net Revenue	sales tax, VAT	Gross Revenue

WHEN ?	Accounting Month	+ DSO (days sales outstanding)	Payment Month
	Jul 14	35	Aug 14

The little tables above give you an indication of how this works in regard to the item "revenue".

To fine-tune this for cash management purposes, break down your figures on a daily basis:

	Net Revenue	VAT	Inpayment
budget July	310.800	19%	369.852
days per month	31		
Revenue date:			
01.07.14	10.026		
02.07.14	10.026		
03.07.14	10.026		
↓			
31.07.14	10.026		
Payment date:			
	11.931		05.08.14
	11.931		06.08.14
	11.931		07.08.14
↓			
	11.931		04.09.14

Now, you may think, it is starting to look complicated. Well, think of this as part of a huge MS Excel spreadsheet in the form of a yearly calendar. Once you have established a rough outline for that calendar, you can take your time and add all the cash-relevant items from your budget broken down into daily, weekly or monthly segments.

And if you handle Excel smartly, i.e. use links between your budget data and your cash calendar, you can change your budget data at a later date and your cash budget will be automatically aligned with those changes. Not to mention that you can use the spreadsheet for next year's budget as well ... and the year after that ...

Let's have a look at an example from the expense side of the budget:

	payroll		out-payments		payable
budget July	310.800	75%	233.100	net wages	30.07.14
		25%	77.700	social security etc	15.08.14
	Net Expense	VAT	out-payment		
budget July	50.000	18%	59.000	tax	10.07.14

The little tables above outline the relationship between some expense items and their cash equivalents.

Usually, it is possible to lump several cost types and/or cost centers together for the cash budget provided they have the same out-payment schedule. If the payment schedule varies within one cost center, a subdivision might also be necessary.

The table below gives an indication of how to align your profit & loss accounts with the payment schedule view by both subdividing cost centers and, in a further step, summing up all those expenses which are identical in payment terms. (This corresponds to the accounting practice of a weekly or bi-weekly payment of all those bills which are due, regardless of cost-type or cost-center.)

Some attention should be paid to those items which have no equivalent on the cash or expense side. The most typical examples are: *depreciation & amortization* as expenses without corresponding payments, and *debt pay-off* or *investments* as cash-relevant items that have no or no direct expense character. These are the items that cause the greatest divergence between the cash result and the profit & loss result, especially if they make up a sizeable share of overall expenses or out-payments, as the case may be.

For instance, huge amounts of *depreciation* over a short period of time may cause a period loss while the bank balance still looks good. The opposite may occur in a year of substantial *re-investment* that has to be written off over a period of ten years: the cash balance has to bear 100% of the investment, while period profit is only affected by 10% of the investment.

And *debt payments* (not interest payments!) are also notorious for taking big chunks out of the bank balance while being totally invisible on the profit & loss side.

Here is a summary in table form:

excerpt from profit&loss accounts	subdivision for cash purposes	re-alignment for cash purposes	out-payment schedule
Marketing expense	Goods and Services Payroll		
Administration	Goods and Services Payroll	Goods and services	weekly
IT expense	Goods and Services Payroll	Payroll	month-end
Depreciation		no cash equivalent !	0
Interest expense			
VAT, sales tax			
other taxes			
no expense equivalent !		debt payments	quarterly

If you have progressed this far, and have fed all these items into your spreadsheet, you have a working cash budget!

2. From Cash Budget to Year-end Cash Projection

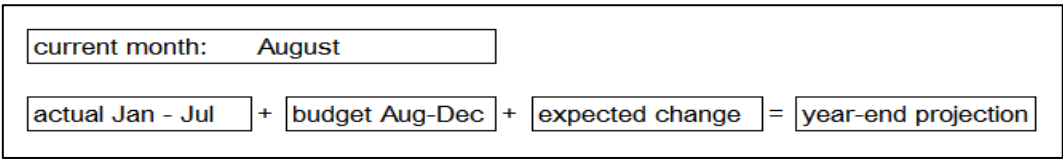
A budget is a good idea – but a budget is also basically STATIC, not DYNAMIC. And as time and your carefully budgeted business year move on, the question of how it will all end becomes increasingly important.

The business plan is kept up to date by substituting actual data for budget data, month by month. If a comparison between actual and budget results shows significant discrepancies – such as a 20% increase or decrease in revenue – and this discrepancy is estimated to continue, then the projection for the remaining months will very likely incorporate this discrepancy instead of sticking to the (in this respect outdated) budget.

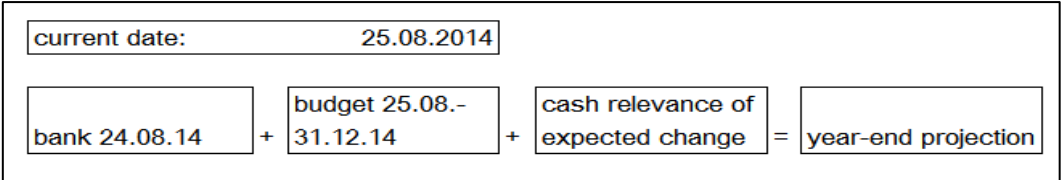
Let’s try to actualize our spreadsheet cash budget on the same principles. What we need is actual figures and a way to work expected variations from the business plan into our cash budget. Actual figures in respect to cash management (your **bank account balance**) are fortunately much more “actual” than a monthly statement of your profit & loss accounts. You can basically actualize them on a daily basis.

Projections should be done in the same way in which they are worked into the business plan / year-end projection.

Business Plan Updating Formula



Cash Budget Updating Formula



And that’s all there is to it.

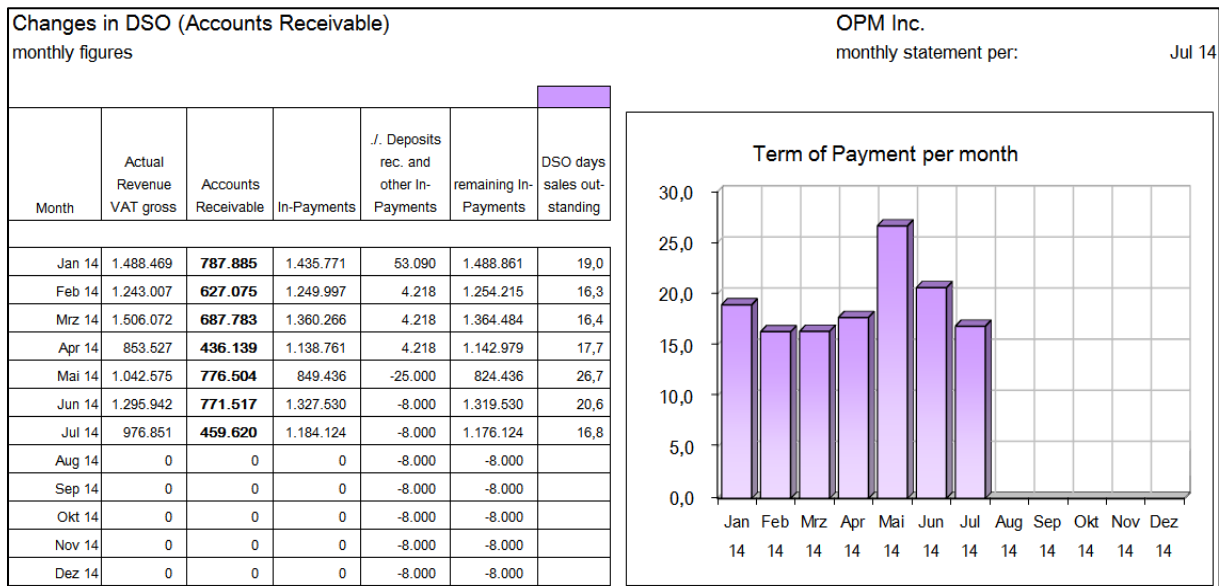
3. From Cash Budget and Year-End Projection to Cash Management

Now you have a working cash budget. You have a year-end cash projection for your liquid assets. You're all set. Theoretically.

Let's not make it too easy and say that your projection shows a bleak bank account balance of (500.000) which would exceed your credit line by some 300.000.

This is where cash management really starts.

The first step in changing that projected bank balance to a more acceptable one is a close look at your in-payments. What is your average DSO (days sales outstanding)?



Is your DSO much higher than the industry average? If so, what can you do to change it for the better?

The next step is an analysis of your out-payments. What is your average DPO (days payments outstanding)? Is it lower than the industry average? If so, do you receive enough in discounts to make this worthwhile?

Do debt-payments eat up most of your remaining bank balance?



Once you have mastered the process of translating revenues and expenses into payments, all these questions are easy to answer. And finding the answer to these questions is essential to your success, perhaps even to your business survival because:

CASH IS KING!

But if you're too busy to work it out all by yourself, why not have a look at a working cash management program in one Excel file in the MagicWorkbooks® library:

Cashmanager4 the "Fill-in-your-budget-and-go" cash management tool

And if you are in a real hurry, try the no-nonsense no-frills version

CashExpress the express way to a cash budget

You need to get a grip on your outstanding money?

These tools might come in handy:

OPChecker free download, determining your DSO

DSOManager managing your outstanding sales for cash-results

You need to rethink your product or service pricing? Have a look at these tools:

PriceCalculator	easy-to-use and complete price calculation
FeeManager	calculate your hourly fees to increase your margin

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