The big picture on cash flow

CommonwealthBank

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The big picture – and what it means for your business

If your cash flow is under pressure, you're not alone. Australian economic growth has slowed markedly in recent months. With consumers borrowing and spending less, business owners around the country are starting to feel the pinch.

The global financial crisis is partly to blame. Falling financial markets saw the All Ordinaries Index fall by 43% in 2008. This was the biggest calendar year decline on record – by comparison, the share market fell by 33% in 1930. As a result, many Australians have seen their wealth significantly impacted. Combined with a seemingly endless string of bad news, that's severely dented consumer confidence.

Stagnating consumer confidence could undermine your profits. In the November 2008 Commonwealth Bank ACCI Business Expectations Survey, indicators of sales revenue and profits were at their lowest levels since the survey began 14 years ago, with 42% of businesses expecting profit growth to fall. And Dun & Bradstreet reported recently that businesses are taking longer to pay their bills, with average payment terms blowing out to 56.5 days in the December 2008 quarter. That suggests cash flow pressures are beginning to bite.

But it's not all bad news. The federal government's economic stimulus package has boosted household spending power, while Australia's 8.3 million home buyers benefitted from a 4% fall in interest rates between September 2008 and February 2009, with the potential for further falls. Meanwhile, the end of 2008 saw significant drops in prices motorists are paying at the bowser.

According to CommSec Chief Equities Economist, Craig James, it all adds up to around $13 million extra in consumers' pockets, even before the government dips into the $26 billion in infrastructure funds at its disposal.

There is no doubt that the economy is slowing and uncertainty over job security is likely to play a part in this trend. However further stimulus packages and projected interest rate cuts will buffer Australian businesses throughout the year.

Going forward, business will be more challenging and that's where the Commonwealth Bank can help. Your Relationship Manager is ready to help your business prepare for the slow-down, with expert advice and practical solutions that keep cash flowing. Call your Relationship Manager today.

Prepared February 2009

Keeping cash flowing

When the economy falters, it's more important than ever to get the fundamentals of your business right. And nothing is more fundamental than strong, sustainable cash flow.

We all know cash flow is important. But as business owners we tend to focus on other things. Sales, expenses, profitability. Often, we only pay attention to cash flow when something goes wrong – and by then it may be too late.

Cash is the fuel that drives your business. The ideas and solutions below will help you keep it flowing, so that you can prosper both in the downturn and the better times ahead.

Top five cash flow problems	Solutions
1. Failing to plan for market volatility and changing conditions	• Be prepared for the potential effects of higher input costs. Consider using risk management tools to reduce your exposure to changing interest rates, commodity prices and exchange rates, and use business risk insurance to protect your assets and your income. • Use an online financial management tool like CommBiz to stay on top of your cash flow position.
2. Tying up capital in stock and equipment	• Turn over excess stock, even at a discount. Consider using leasing solutions for equipment, instead of tying up cash.
3. Buying long-term assets out of current cash flow	• Use longer-term lending solutions for capital assets. Match the length of the loan to the life of the asset.
4. Collecting accounts receivable too slowly	• Monitor accounts receivable carefully. Have a system in place to follow up overdue accounts. Use electronic payment solutions to put cash in your bank account faster.
5. Failing to put excess cash to work	• Look for cash reserves in your business, such as cash you've set aside for stock or GST liabilities. Earn extra profits for your business using the right investment option for the holding period – short, medium or long term.

Case study – when cash flow turns to a trickle

The problem

Everest Roofing was a successful construction business whose sales continued to grow, despite more difficult trading conditions. But, even while sales were rising, Everest had a growing cash flow problem.

Most of their suppliers were paid cash on delivery or on seven day terms, while it took them an average of 60 days to collect on customer accounts. At the same time, expenses were on the rise as they ramped up to fulfil new orders. The result was that their cash balance was shrinking, even while sales were soaring.

The solution

First, Everest needed to understand the problem. So they created a cash flow tracker, plus a cash flow projection for the rest of the financial year.

Next, they used a loan to fund purchases of equipment, freeing up extra cash. And they negotiated longer terms of trade with key suppliers.

Finally, they agreed on new payment terms with their customers and put a system in place to manage accounts receivable.

The result

With new terms of trade in place, Everest increased their payments cycle to an average of 60 days, while reducing the time lag between making a sale and banking the revenue to an average of 30 days.

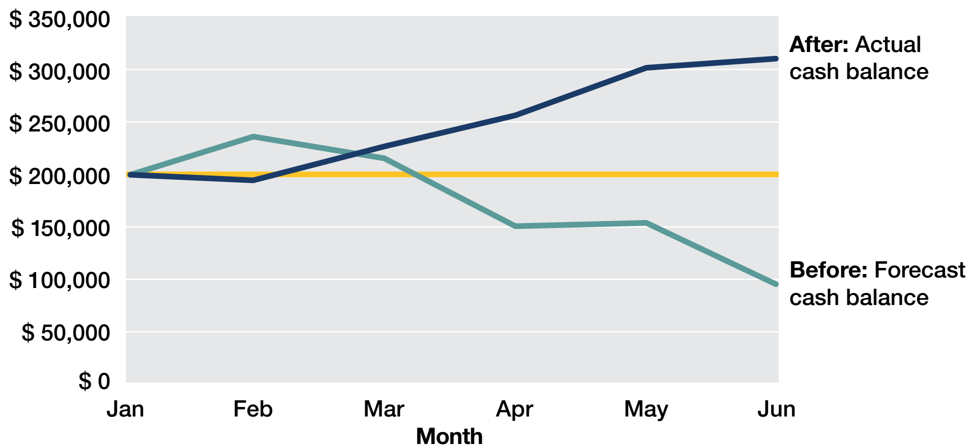
By using a loan to pay for vehicles and equipment, instead of buying them out of current cash flow, they freed up extra funds and made it possible for the assets to pay for themselves over the life of the loan.

The result was that they turned a forecast fall of $96,000 in their cash balance into a $123,000 increase.

The problem: Everest's cash flow forecast shows a 60-day time lag between sales and receipts ($'000)

	Jan	Feb	Mar	Apr	May	Jun
Sales	**106**	**138**	174	151	258	237
Expenses	95	124	157	136	232	213
Cash receipts	140	90	**106**	**138**	174	151
Cash balance	200	245	211	160	161	104

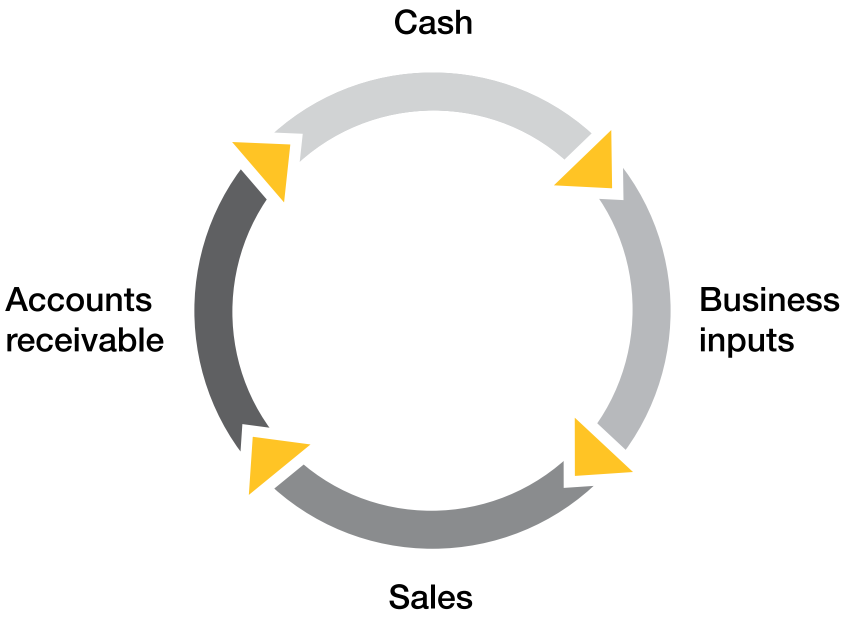
The solution: reduce payments and bring forward receipts



This is a hypothetical example for illustrative purposes only and does not represent any particular individual or company.

Speeding up the cash flow cycle

This is the cash flow cycle. Every dollar you invest in your business goes through the cash flow cycle before it comes back to you – hopefully bringing an extra few cents of profit with it. So the faster you can make the cycle turn, the more successful your business will be.



Stage 1: Cash

The cycle begins with the cash you invest in your business. Much of it will come from current cash flow, but at some point you are likely to need other sources of finance – whether to buy equipment, expand, or simply fund ongoing operations while waiting for invoices to be paid.

Managing cash	
Your objectives	• Access the capital you need, without starving your business of cash for day-to-day activities. • Drive down your overall cost of funds.
The approach	• Like other business inputs, money has a cost. By analysing your capital requirements and planning ahead, you can choose the right financing option for each purpose, reducing your overall cost of capital. Your Relationship Manager can help. • The key is to match the life of a loan to the life of the asset you're buying. That way, the asset can potentially pay for itself as it produces income over time.
Tools	• An essential first step is to create a cash flow forecast and tracking tool. Many popular accounting packages have a cash flow module; you can also create your own. Visit **commbank.com.au/cashflow** to download a Cash Flow Tracker template that can help you forecast and analyse cash flow. • Use CommBiz to get an instant snapshot of your cash flow position, 24 hours a day. • When unexpected costs crop up, a Business Overdraft can help you find the funds you need, and manage your changing cash flow requirements through the year. • For longer-term purchases, a BetterBusiness Loan is a flexible financing option with a choice of repayment options to suit your cash flow requirements. • Instead of leaving cash reserves in your Business Cheque Account, consider a Business Online Saver, with a high interest rate for balances of $10,000 or more.

Stage 2: Business inputs

Business inputs include everything you need to generate sales, from stock to salaries. Some are fixed costs, which are usually non-negotiable. But you may be able to reduce other expenses or delay payment by negotiating with your suppliers.

Managing business inputs	
Your objectives	• Reduce expenses or delay payment. • Keep stock levels to a minimum.
The approach	• Negotiate with key suppliers to improve your terms of trade. For example, instead of paying on seven-day terms by cheque, arrange to pay them at the end of each month by electronic funds transfer. They'll save on paperwork and be able to access the money immediately – and you'll improve your cash flow position. • Alternatively, consider negotiating a discount for prompt payment. • Monitor stock levels constantly. Don't hold on to excess or outdated stock. • Try to forecast your future production needs and buy raw materials *just in time*. Remember, the longer you can delay spending money, the better.
Tools	• CommBiz is a premium online banking solution for business users. Use the Payables functions to securely pay suppliers in Australia and overseas by fund transfer or Direct Credit – then track your accounts and transactions in real time.

Stage 3: Sales

This is the stage of the cycle that business owners usually focus on – the stage you probably know best. The key is to get your pricing right, so that every sale is a profitable one.

Managing sales	
Your objectives	• Make every sale a profitable sale. • Focus your sales and marketing on key customers.
The approach	• When pricing your goods and services, make sure you accurately take into account all of the costs of doing business, including overheads, administrative costs, and the cost of accessing working capital. • Price to maximise your overall profit, not your sales. • Identify your key customers and focus on getting them and keeping them. According to the Pareto Principle, around 80% of sales come from 20% of your customers. Which means you need to identify that 20% and concentrate your resources on them.
Tools	• Commonwealth Bank research can give you essential insights into current economic conditions and future trends that may affect your business and therefore your customers. Ask your Relationship Manager to provide you with access to the research most relevant to you.

Stage 4: Accounts receivable

For many businesses, this is the problem stage of the cash flow cycle. Without careful management, accounts receivable can quickly get out of control. Remember, a sale is not complete until you've been paid in full.

Managing accounts receivable	
Your objectives	• To reduce the time lag between making a sale and putting money in the bank.
The approach	• Carefully track the average number of days your accounts receivable are owing. Then try to reduce that number. • Negotiate shorter terms of trade with key customers, and make sure they understand your terms. • Ask to be paid by credit card or electronic funds transfer, so that you don't spend time waiting for cheques to clear.
Tools	• Electronic receivables solutions like BPAY®, Direct Debit and merchant solutions put cash in your account faster and make it easier for customers to buy from you. They also make it easier to track and reconcile payments, slashing paperwork and administrative costs. • If you are already a Commonwealth Bank merchant customer, consider nominating a Commonwealth Bank transaction account as your linked account. That way, receipts will generally be credited to your account on the same day, and be available for use on the next business day. Whereas, if you nominate an account held with another bank, it could take 48 hours or more until the money is available. • Use CommBiz to keep track of cash inflows across all of your Commonwealth Bank accounts and download daily electronic reconciliation files to your preferred accounting package.

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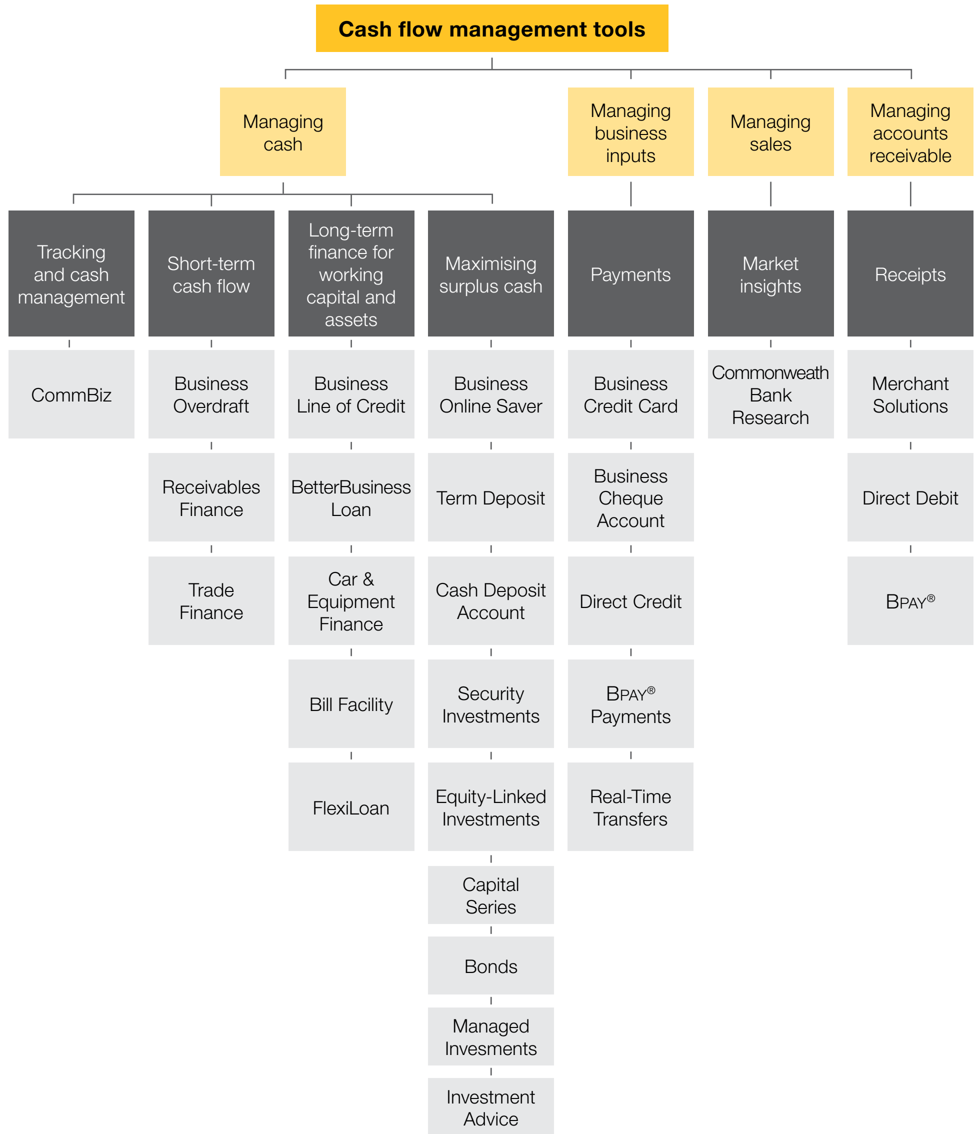
Your cash flow toolkit

Choose from our range of cash flow management tools to build a total solution for your business.



Case study – closing the cash flow gap

The problem

Forest Dermatology was a thriving skin care business with five clinics in Melbourne and its own range of skin care products. But Forest Dermatology risked becoming a victim of its own success.

Following rapid growth, the business faced three related cash flow problems:

- It was increasingly difficult to keep track of expenses across all five clinics.
- The ingredient suppliers for Forest's skin care range demanded payment in advance, while customers took up to 60 days after delivery to pay. That left Forest with a significant cash flow gap.
- Forest had received an offer from a US department store keen to sell their range. They knew that they would need to start sourcing ingredients offshore – but were concerned about paying for imported goods, sight unseen.

How could they make the most of their growth opportunities without expenses spiralling out of control?

The solution

On the advice of their Relationship Manager, Forest Dermatology:

- Gave authorised employees at each clinic a Commonwealth Bank Charge Card. By channelling all expenses through a single card facility, they were able to keep tight control of expenditure.
- Set up a Receivables Finance facility, allowing them to access 80% of the value of a sale on the same day the invoice was issued. That meant they had the funds to buy ingredients and fulfil each order, without having to cover the cash flow gap.
- Used Letters of Credit for overseas purchases, ensuring that suppliers were only paid after they provided evidence that the goods had been shipped.

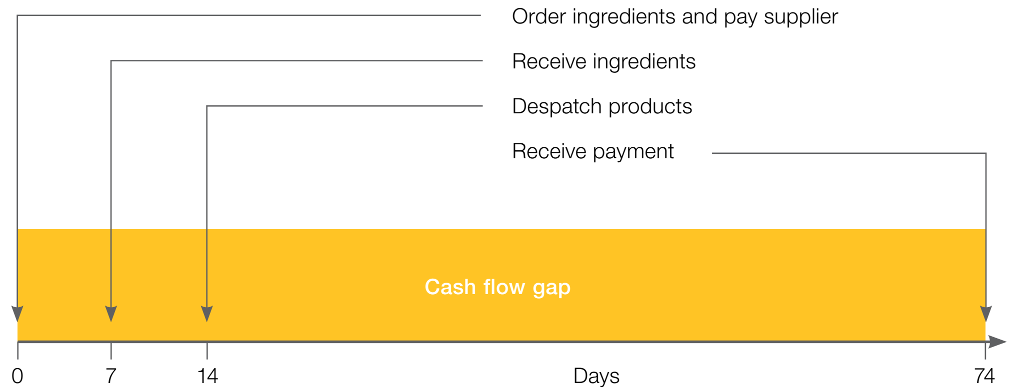
The result

Thanks to the Business Charge Card facility, Forest Dermatology was able to streamline and centralise expense management, while slashing paperwork. CommBiz gave them complete control, with all transactions clearly recorded online and available to print or download.

The Receivables Finance facility allowed them to expand their manufacturing operation and buy the supplies they needed. They even took advantage of their suppliers' discounts for early payment!

Using Letters of Credit both to import ingredients and to export products, they were able to expand the business offshore without taking on too much risk. And with CommBiz Trade, they were able to manage and track Letters of Credit quickly and easily, 24 hours a day.

The cash flow gap



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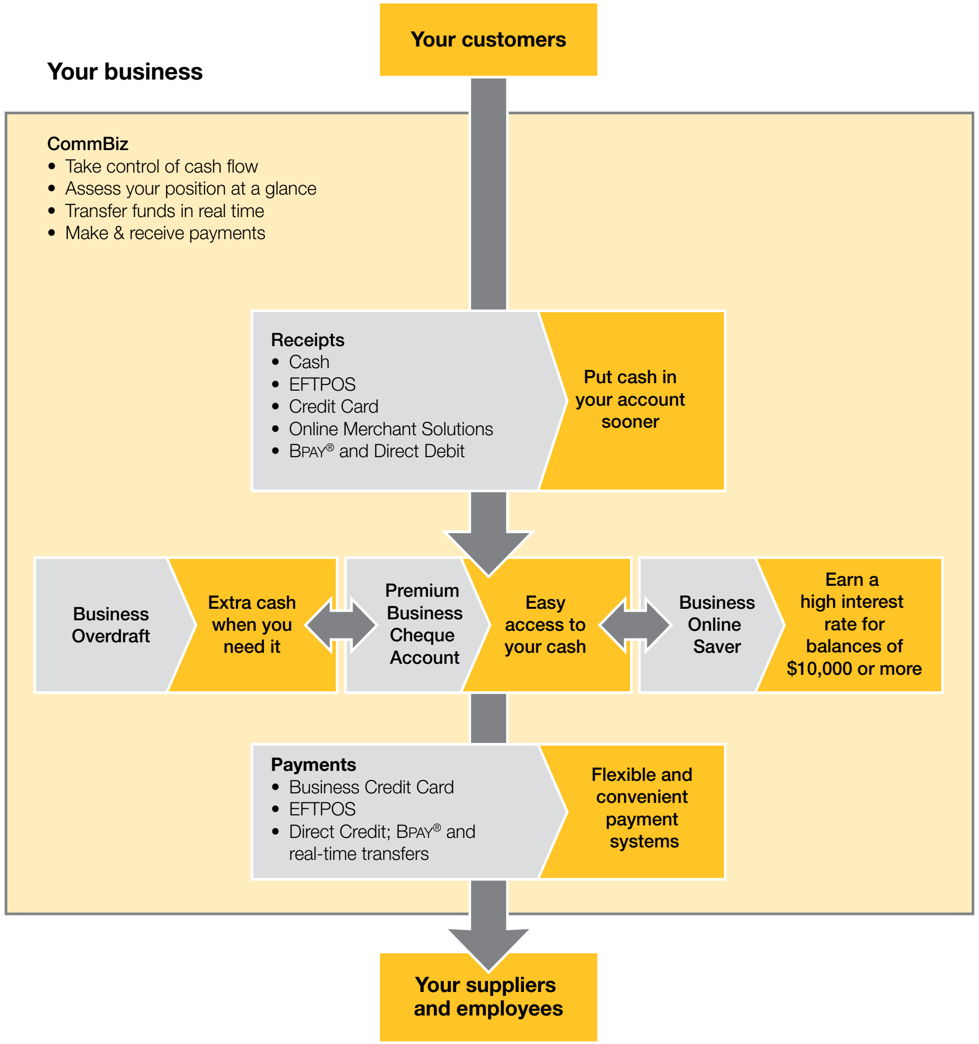
Build a tailored solution

Here's an example of how you can put the pieces together to create a solution tailored for your business.



Five steps to better cash flow

1.	Ensure you have funds available for short-term cash flow, such as an overdraft or surplus cash.
2.	Make the most of temporary cash reserves using a high interest cash account, such as Business Online Saver.
3.	Focus on your most profitable customers.
4.	Identify sources of potential cost blowouts, such as rising commodity prices or volatile foreign exchange rates, and put a plan in place to deal with them.
5.	Speed up accounts receivable days by offering your customers Direct Debit or BPAY® and following up unpaid invoices methodically.

We're here to help

How to contact us

To find out more about cash flow solutions:

- Call your Relationship Manager
- Visit **commbank.com.au/cashflow**

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