Allianz

How to protect your cash flow

A guide for small and medium businesses

Introduction

Cash has always been king for small businesses and medium companies, but SMEs around the world are facing heightened levels of risk. Today, it's more important than ever to protect your company growth with cash flow management.

This ebook takes you on a journey to improve your business risk management, to safeguard money owed to you and ensure that in the event of bad debts, it won't be you who pays the price.

Where will your cash flow management journey begin?

1 Cash flow explained

cash flow *noun*
The amount of cash that is generated (by sales for example) or consumed (bills, salaries, etc.) in a given time period. It differs from profit, which is the amount of money left over when all the costs associated with creating and delivering a product or service are considered.

Common cash flow terms

Accounts receivable
The money owed to your business for products sold or services rendered.

Amortisation
An accounting technique used to lower the book value of a loan or intangible asset periodically over a set period of time.

Balance sheet
A document that identifies the value of business by 'pricing up' assets, liabilities, capital and reserves.

Capital expenditure
Money spent by a business on buying or maintaining fixed assets, such as land, buildings, or equipment.

Depreciation
A reduction in the value of an asset over time, due to wear and tear in particular.

Net income
The amount of earnings after all expenses have been deducted from sales.

Profit and loss statement
Often abbreviated to 'P&L', this is a statement of your business's income and its expenses.

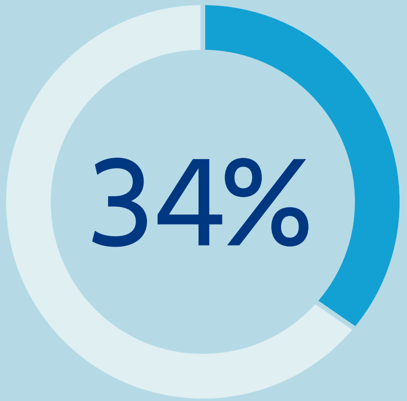
Revenue
Your company revenue is worked out by multiplying the number of invoices paid to the business by their value.

Working capital
Money businesses can spend, as opposed to money tied up in assets.

Why is cash flow management so crucial?

A regular supply of cash is vital to any organisation, so that it can pay salaries and bills, as well as invest in growth.

Even profitable companies can become insolvent if cash flow is disrupted, for example if customers don't settle invoices on time.



of SME business owners rely on overdrafts to cover late payments[1]

small businesses fail to pay staff on time because of cash flow problems[2]

of invoices are paid on time[3]

1. BACS
2. Intuit Quickbooks
3. FreeAgent

2 Essential cash flow knowledge

Poor cash flow management has been the downfall of too many businesses and it's something you can't leave to chance. It's vital to have a thorough understanding of where your money is coming from and to project future revenue to secure company growth.

How to read a cash flow statement

A cash flow statement lists your business transaction history, including all incoming and outgoing money. Importantly, it records payments, not invoices, so it does not include cash promised to the business and expenses you are yet to pay.

The statement includes income from sales and investments, as well as liabilities including pay, dividends, share sales and financing, such as loan repayments.

What a basic cash flow chart looks like

Cash flow from operations	
Net income	€60,000
Additions to cash	
Depreciation	€20,000
Increase in accounts payable	€10,000
Subtractions from cash	
Increase in accounts receivable	(€20,000)
Increase in inventory	(€30,000)
Net cash from operations	€40,000
Cash flow from investing	
Purchase of equipment	€5,000
Cash flow from financing	
Notes payable	€7,500
Cash flow for month ended 31 january 2022	**€42,500**

of SMEs describe themselves as cash flow positive[2]

How to calculate cash flow

Once you're familiar with reading a statement, calculating cash flow is simply a matter of comparing cash coming in with cash going out. As long as the first number is bigger than the latter, you have positive cash flow.

To test yours, pick a time period (for example, the past three months) and add up your revenue from settled invoices. Then subtract your business' liabilities (costs such as Accounts payable, Interest payable, Income taxes payable, Notes payable or Wages/Salaries payable) over the same time period.

For a deeper understanding of how much cash is available to spend, you can calculate 'free cash flow' by using the following formula[1]:

Net income
\+ depreciation/amortisation
– change in working capital
– capital expenditure

= free cash flow

Refer back to our Common Cash Flow Terms.

1. Wave
2. Xero – Dec 2019

How to create a cash flow projection

An up-to-date cash flow statement is an important tool to help you understand the current financial health of your business. A cash flow projection is very similar, the only difference being it uses estimated figures to give you an idea of what's in store over the coming weeks and months.

To make one, you must pick a timescale – for example seven months in the future – and estimate the value of your transactions over that period.

Start with a sales forecast (especially recurring invoices, which you can predict with some certainty), then add other inflows such as investments, grants, asset sales and tax rebates.

Then list future overheads, including salaries, rent, hardware, software and tax.

Use the two numbers to work out if you will have a positive or negative cash flow.

Example of a cash flow projection

	January	February	March	April	May	June	July
Cash at start of the month	**5,000**	**3,340**	**3,080**	**2,220**	**1,960**	**1,700**	**-740**
Cash coming in							
Sales paid (75%)	7,500	7,500	7,500	7,500	7,500	6,000	6,000
Collections of credit sales	2,000	2,000	2,000	2,000	2,000	1,600	1,600
Total cash in	**9,500**	**9,500**	**9,500**	**9,500**	**9,500**	**7,600**	**7,600**
Cash going out							
Inventory	4,500	4,500	4,500	4,500	4,500	4,500	4,500
Rent	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Wages	4,000	4,000	4,000	4,000	4,000	4,000	4,000
Utilities	100	100	100	100	100	100	100
Phone	30	30	30	30	30	30	30
Insurance	1,200	0	0	0	0	0	0
Ads	200	0	0	0	0	0	0
Accounting	130	130	130	130	130	130	130
Miscellaneous	0	0	600	0	0	0	0
Loan payments	0	0	0	0	0	0	0
Taxes							
Total cash out	**11,160**	**9,760**	**10,360**	**9,760**	**9,760**	**10,040**	**9,760**
Cash at the end of the month	**3,340**	**3,080**	**2,220**	**1,960**	**1,700**	**-740**	**-2,900**

"Sales paid" is the amount of cash received in a given month for goods/services supplied during that month. (The "75%" note indicates that only three-quarters of the cash due for sales made in any month will be received during that month.)

"Collections of credit sales" refers to the amount of cash received during a given month for goods/services that were supplied in previous months.

3 Our six-step guide to keeping track of your cash flow

From helping you put best practices in place, to identifying the key warning signs, follow our six simple steps to track your cash flow and keep your business safe.

1

Keep good records

Good record-keeping might not be the most fun part of running an SME, but it is the cornerstone of a healthy business. Take time to log company income and expenses, and keep the information timely. You'll have a clear picture of your company's financial position and will be able to spot any early warning signs.

2

Look for early warning signs

Have you just taken on a massive order from a new customer without doing the necessary credit checks? Other 'red flags' to watch for include customers looking to change payment terms and non-stop excuses as to why they can't pay you.

3

Create a cash flow statement and prediction

Put your information to work. By bringing it together in a cash flow statement and, separately, a prediction of future cash flow, you'll have much greater awareness of likely opportunities and threats going forward.

4

Review every month

Projections and statements are only useful if you learn from them, so set aside time each month to compare real-world figures to your projections. If they differ, work out why and take steps to improve your financial forecasting.

5

Invoice quickly and chase late payments

Late payment applies to outstanding invoices. Always make sure you invoice as soon as possible. Make a note of the invoice details and follow-up with your client as the due date approaches, rather than waiting until it's overdue, particularly with invoices for large amounts.

If they miss the payment deadline, keep up the dialogue and ensure they understand that you won't accept non-payment. See also What to put in a late-payment letter?

Keep information about your invoices in an accessible format that gives you a clear picture of who has paid on time and who settles late. You can charge interest on late payments.

For businesses based in the UK visit the Small Business Commissioner website for more details.

On average small businesses wait 7.3 days longer than their invoice deadline

Xero

6

Use software

There are many digital accounting products on the market that will help you manage your cash flow. These order your invoices, log payments and present a clear picture of the money flowing in and out of your business.

4 Optimising cash flow within your business

Now that you've mastered the basics of cash flow, it's time to deal with the details that ensure the process runs smoothly.

Cash flow optimisation best practices

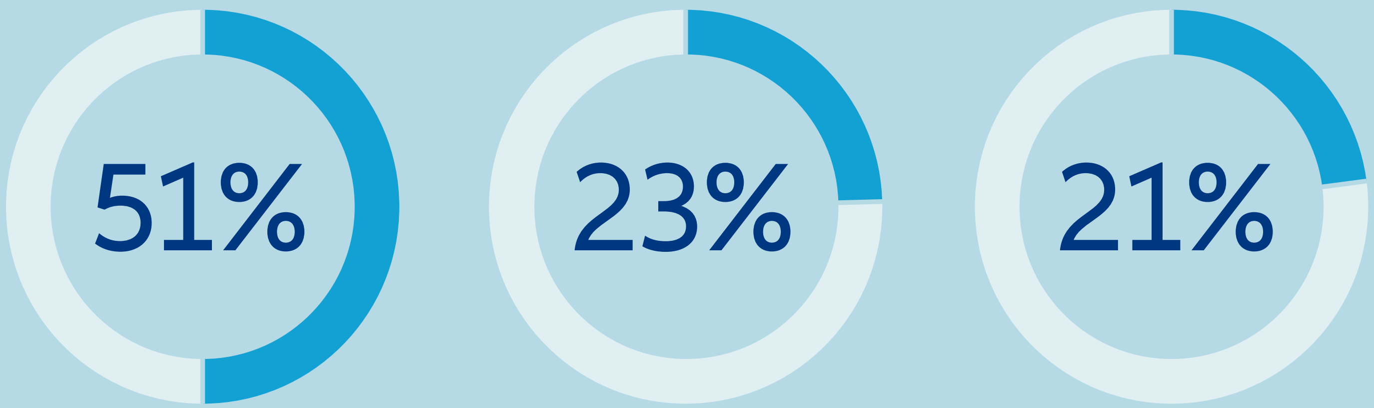
- Make frequent projections of your cash flow position and act on the conclusions.
- Be alert to emerging threats, including debtors, any extra-large bills and loan repayment dates.
- Encourage your team to learn basic cash flow management and credit control principles, so they are aware of business needs too.
- Research digital cash flow tools that provide a clearer picture of your cash position. Examples include Pulse, Fluidly, and SlideBy.

Tips for credit control and faster payment

Once you have put in place best practices in terms of cash flow optimization, you can turn your attention to streamlining payments.

1. If possible, get to know the person responsible for settling invoices at your client's business.
2. Invoice immediately and ask your client to acknowledge receipt.
3. Ensure your invoice is accurate and all the details are correct.
4. Keep this receipt on file to prove that you delivered the invoice successfully.
5. As the payment deadline approaches, follow up with a friendly reminder that you expect prompt payment.
6. Chase late payment quickly and firmly. Check out our What to put in a late-payment letter?
7. Establish an automated reminder process to remind clients of their payment obligation.

The three biggest payment pain points for small businesses



chasing late or non-payment

the cost of receiving payment is too high

keeping track of payment

Source: Bill.com

What to put in a late-payment letter?

Chasing late payments is a pain, but you can improve your success rate by including:

- Details of both companies (name, address)
- Date of your letter
- Key contact at your company
- Payment references, invoice number
- Total owed + interest or charges if you choose to add them (explain these charges)
- Explain clearly that the payment is past due and the customer has breached terms
- Refer to previous communications
- Information about what happens next, including final payment date and the consequences if your customer still won’t pay (debt recovery, legal proceedings).

5 Protecting your business against poor cash flow

It can be difficult to predict bad debt, but you can protect yourself against it. This section will help you keep an eye out for the common cash flow pitfalls and pick the right customers to trade with.

Common cash flow pitfalls

Overspend
Spending too much can be as damaging to company growth as earning too little. As part of your business risk management strategy, keep a close eye on spend, ensure people understand their responsibilities and keep regular accounts of all the money leaving the business.

Failure to create a cash cushion
A cash buffer is like a rainy-day fund that your business can access in an emergency, such as key machinery breaking down or a big invoice being overdue. Ring-fencing capital protects your business against the impact of unanticipated spend. Check our example of a cash reserve formula.

Wishful thinking
It's good to be optimistic about your future, but sales forecasting must be realistic if you plan to spend against it. Have regular meetings or discussions with your sales team as over-estimating future income will put a strain on your business.

Not creating a financial plan
You should know exactly how much you expect to spend and collect each month based by monitoring cash flow on a daily basis and analysing historic data to assess future cash flow (see How to create a cash flow projection).

Allowing late payments
Delays in invoice payments can have a disastrous impact on your business. Create clear credit policy: offer a discount for early payment and penalties for late settlement.

It makes good business sense to research markets and the payment records of individual countries before dealing with them. If your business can cope with a longer average DSO, then factor this into your income forecasting.

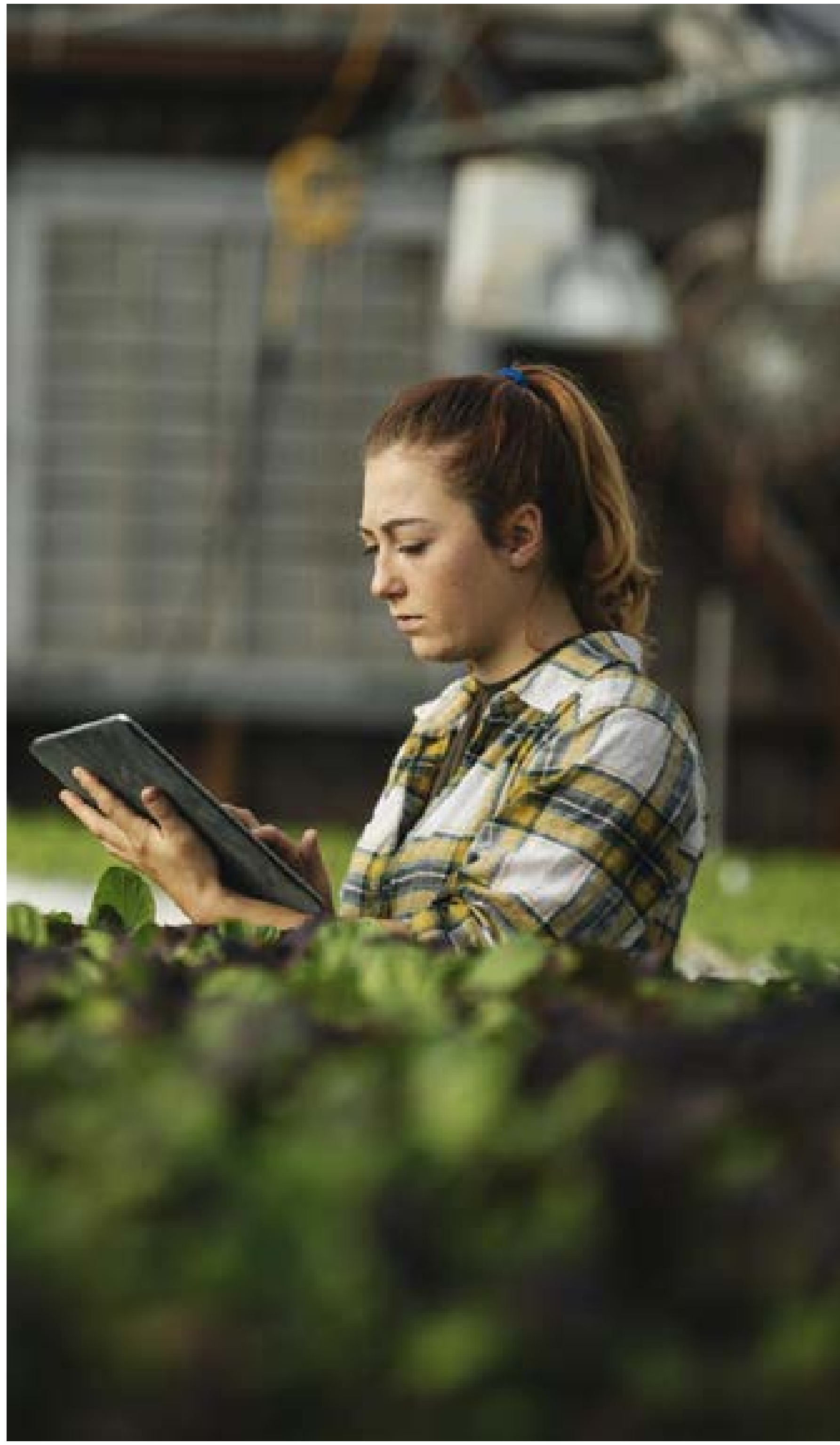
To get more information on non -payment risk per country, check our country risk reports on allianz-trade.com.

There are several ways to protect against late payments, including trade credit insurance (see Section 6)..

Pick the right customers

A great way to minimise the impact of late payment is to re-search potential customers
thoroughly before doing business with them.

Call on local partners to gain insight and build relationships with prospects. It’s also
important to dig beyond their financial ratings and look into whether their strategy and culture are in line with your own. You can also consider whether they have risk coverage, like trade credit insurance.



Operate internationally? Know your markets

For SMEs that operate in international markets, it's worth keeping an eye on macroeconomic data, which will help you understand the context that your business is facing overseas.

Late payment isn't always avoidable

Sometimes late payment is hard to avoid and it's just the way things work. According to our research, China has the longest average Days Sales Outstanding (DSO) in the world at 94 days (the global average is 66 days) as of 2020. DSO is a measure of the average number of days it takes a company to collect payment after a sale has been made.

Top 5 countries with the longest DSOs

1	2	3	4	5
China	Italy	Greece	Turkey	Spain
94 DAYS	89 DAYS	83 DAYS	82 DAYS	80 DAYS

Top 5 countries with the shortest DSOs

1	2	3	4	5
New Zealand	Finland	Netherlands	South Africa	Australia
37 DAYS	44 DAYS	45 DAYS	47 DAYS	50 DAYS

Source: Allianz Economic Research, 2020

6 Moving forward: next-level protection

The first thing to note is that you're not alone. Third-party expertise and services can help your business protect against credit risk, safeguarding company growth.

What are your options?

Trade credit insurance
A business insurance solution that protects you against bad debt from non-payment of commercial invoices. It empowers companies to grow with confidence by guaranteeing against poor payers. It expands a company's finance options with secure receivables and allows exporters to offer more open terms in overseas markets. Trade credit insurance isn't only for big companies; it can be adapted for firms of all sizes.

Internal credit management
Companies use internal credit management to bear the burden. This 'bad debt reserve' is easy to administer, but it ties up working capital and companies must sometimes absorb debts they can't recover.

Invoice finance
An invoice finance supplier will buy your invoices at a rate lower than their face value, then chase the payments themselves. This gives you immediate access to cash, but it doesn't always guarantee payment and you lose an important part of your relationship with customers.

Letter of credit
Obtaining a letter of credit from your customer means their bank guarantees payment. It provides security, but can be time-consuming, especially if your customers must raise a letter of credit against each invoice.

Focus on trade credit insurance

Trade credit insurance is a useful tool against bad payers. It insures your business against losses incurred from bad debts, meaning that (subject to conditions) your business can be confident that every invoice will result in payment.

If your customers become insolvent or fall into protracted default, you will be indemnified for the cost of goods and services you have delivered.

Learn more about trade credit insurance on allianz-trade.com

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Conclusion: The top 10 actions to be a "cash flow superhero"

By now you should have a good grasp of cash flow management best practice. To recap here's a checklist of the top 10 things you can do straight away.

1 Research potential customers thoroughly

See how to Pick the right customers

2 Draw up a forecast of income and outgoings

Read our Six step guide to keeping track of your cash flow

3 Follow credit control best practices for faster payment

See also our Tips for credit control and faster payment

4 Equip your business with digital tools that keep track of invoices and spend

Check out our recommended tools with our Cash flow optimisation best practices

5 Return to your projections regularly and learn from them

Take a look at number 4 on our Six step guide - review every month

6 Consider using third-party expertise or services, such as trade credit insurance

See What your options are

7 Before making a big investment, always consider what impact it will have on your cash

Take a look at our Common cash pitfalls for more advice

8 Save a proportion of your cash to cover unexpected liabilities

Take a look at our Common cash pitfalls for more advice

9 Research international markets to understand the context of your export business

See also our advice on Knowing your international markets

10 Talk to us about our suite of products

Find out more about How we can help you

Where next?

Allianz Trade has a wealth of expertise and experience in delivering trade credit insurance to thousands of customers world-wide. We offer useful insight and guidance to help you identify the right customers and steer clear of common pitfalls.

For more information, visit: allianz-trade.com

We hope you found this ebook useful. Remember that Allianz Trade is on hand to help you boost your cash flow management practices as you continue your business growth story.

Visit allianz-trade.com to contact us or get more information.