



9 SMART STRATEGIES TO IMPROVE YOUR PROFIT AND CASH FLOW



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Profit may not be the first thing aspiring business owners think of when they dream of taking control of their own destiny. They are often more focused on the product or service they are offering. Once you've been in business for a while though, you learn it's the determining factor between success and failure. Everything you do to drive profit will help your business to survive and thrive.

Cash is as vital as profit, if not more so. You can easily be making a profit, but get into trouble running out of cash.

If these are two of the most vital issues affecting business survival, let's look at how you can proactively handle them.



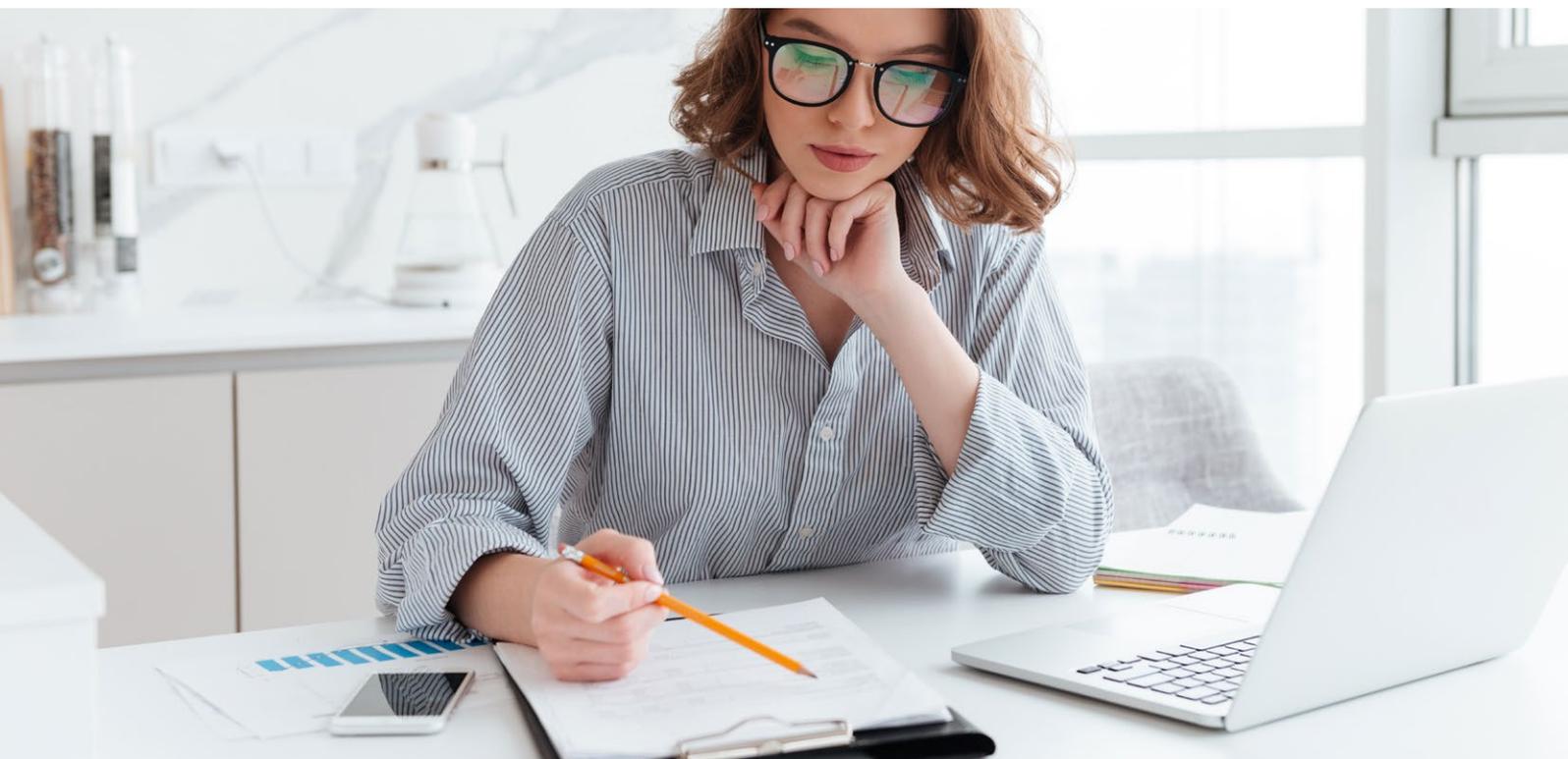
01 HAVE A PLAN

There's an old saying "Most businesses don't plan to fail, they just fail to plan". If you want to achieve a desired outcome you need to consider what actions are required to get there. The key elements of profitability are Sales, Costs and Overheads.

- ▶ Plan how you are going to achieve your desired sales levels
 - ❑ What are you going to sell?
 - ❑ How much of it are you going to sell?
 - ❑ Who are your target customers?
 - ❑ What marketing are you going to implement?
 - ❑ How will you measure effectiveness of your marketing?
 - ❑ How will you manage sales enquiries?
 - ❑ How will you measure effectiveness of your sales process?
 - ❑ How much marketing and sales activity do you need to perform to achieve the sales you desire?



- ▶ Plan your costs and how to minimize them
 - ❑ Understand the 'true cost' of your product/service, including everything involved in getting it ready for sale. This enables you to set the right price to ensure a decent margin.
 - ❑ Shop around to get best pricing on what goes into creating your product/service.
 - ❑ Constantly monitor costs to ensure they aren't creeping up and so that you know when to either seek better pricing from suppliers or increase your price to maintain your margin.
- ▶ Plan your overheads and how to minimize them
 - ❑ Understand what overheads you need to run your business each month. These are different to the costs of the product/service e.g. rent, admin salaries, office supplies etc.
 - ❑ Shop around for the best price or most efficient way of achieving things. For example do you really need a fixed office space? Could you run from a combination of a home office and casual office space when required?
 - ❑ Constantly monitor overheads to ensure they aren't creeping up and eating all your profit.



02

UNDERSTAND THE BENEFITS OF A BUDGET

A budget is one of the most powerful tools you can use to ensure you end up with a profit.

The benefits of a Budget

- ▶ It acts as a 'Roadmap' by setting out an exact future plan of sales, costs and overheads.
- ▶ It reveals waste by comparing to actuals each month.
- ▶ It aligns priorities within the business e.g. everyone can be allocated their own area of responsibility and a budget to do it.
- ▶ Reduces stress because everything can be seen in black and white clearly.
- ▶ Builds new habits because variances can be investigated and fixed.
- ▶ Controls spending because people within the business understand there are limits.



- ▶ Develops a sense of ownership because everyone understands what the goals are and their part in achieving it.
- ▶ Co-ordinates efforts because everyone can see the 'big picture' and where they fit in.
- ▶ Improves productivity from a sense of awareness because people are reminded constantly of the need for efficiency to create profit and business longevity.
- ▶ Accelerates financial goals – if you regularly celebrate achieving the budget this inspires everyone to want to achieve more.
- ▶ Provides a base from which progress is measured.

If these are the benefits of a budget, why doesn't everyone have one? If you need to go somewhere and know the destination but not the directions, you wouldn't just get in your car and drive. Yet this is what some businesses do, they know they want to make a big profit, but have no plan or idea how to get there. This is what your budget is, a GPS or street directory on how to get there, complete with road signs and speed camera warnings.

One more big benefit of a Budget is that it gives your bank or lender confidence that you've got control of your business finances. It reduces the risk for them and hence, they see you as a good customer.

03

UNDERSTAND THE BENEFITS OF A CASH FLOW FORECAST

If a Budget is the most powerful tool to ensure profit, then a Cash Flow Forecast is a great tool to help you manage successful cash flow.

Some benefits of a Cash Flow Forecast

- ▶ Helps you to see the difference between profit and cash flow.
- ▶ Predicts your cash position if assumptions are met.
- ▶ Helps you to see the peaks and troughs in cash flow before they occur.
- ▶ Enables you to take corrective action before an issue arises.
- ▶ Reduces stress because you can see in black and white what the position will be.
- ▶ Gives staff confidence you have your finger on the pulse of your business.
- ▶ Clearly indicates what you need to change to improve cash flow e.g. collect payments from customers quicker, negotiate better terms with suppliers, focus more attention on sales, find ways to reduce wasteful costs/expenses.
- ▶ Controls spending because people can see clearly what impact overspending causes.
- ▶ Helps you to decide the best time to buy stock, equipment etc.
- ▶ Helps you to decide when to pay suppliers, dividends etc.
- ▶ Helps you to decide when to place surplus cash in high interest accounts

A business doesn't survive solely on profits... it survives on cash. Growing businesses especially need to be very attentive to their cash position, because, as sales rise, typically so do the costs associated with these sales. And most of the time, you need to pay for these costs before you get paid by your customers.

As business grows even profitable companies can run into cash flow problems.

04

USE THESE BUDGETING TIPS

- ▶ Set realistic expectations
 - You are rarely going to get your sales budget completely accurate. Sales and marketing plans help this by building your budget 'from the ground up'.
 - Don't budget to double sales if you're not doing anything different.
 - Make sure you can justify your growth plans.
- ▶ Separate 'fixed' expenses from 'variable' expenses
 - Fixed expenses such as rent, admin salaries, motor vehicle expenses, internet/phones, insurances etc. As a general rule 'fixed' expenses don't change with the level of sales activity.
 - Variable expenses, such as production costs, direct labour costs e.g. service people. 'Variable' expenses change with the level of sales activity e.g. the more or less widgets you sell the more you need to buy.
- ▶ Categorise expenses
 - Occupancy such as rent, power, building and contents insurance
 - Admin such as admin salaries, superannuation, workers comp etc.
 - Marketing and Sales such as advertising, outsourced marketing help, sales aids etc.
- ▶ Allow for contingencies – nothing ever goes completely to plan, so consider a little buffer just in case.
- ▶ Check for adequacy – will the expenses you've budgeted for be enough to generate the sales you've budgeted e.g. Marketing Plan says you are going to visit 100 distributors across the country to make \$50,000 in extra sales. That's great, but you need to make sure you have budgeted for the people required and travel costs necessary to do this. This is the benefit of linking your updated plans to your Budget.



05

USE THESE CASH FLOW FORECASTING TIPS

- ▶ Compare your actual cash flow against forecast at least weekly.
- ▶ Find out why there are significant negative variations to forecast and take corrective action immediately.
- ▶ Update your forward forecast – this enables you to stay in control of your cash flow.
- ▶ Revisit your Marketing Plans, how you invoice customers, spending etc. The ideal is to have the cash on hand to meet all your payroll and supplier requirements on time, but not be holding onto more cash than is needed, even when unanticipated expenses are considered.

06

UNDERSTAND THE POWER OF BREAK-EVEN

Break-even sales, is the amount of sales you need to make to avoid a loss i.e. to achieve a \$0 profit or loss result.

Obviously the objective of business isn't to break-even, but to make a profit and avoid losses. What we often hear though, is that many businesses don't know their break-even point and therefore don't set targets weekly/monthly to ensure they are profitable. A great start to profitability is to know what your break-even point is. Once you know this, you can use it as a basis for setting your targets of profitability. You can give each salesperson, division or team individual targets to achieve overall profitability.

Break-even is impacted by fixed and variable costs. Fixed costs are those that you incur all the time, e.g. rent, admin wages, telephone etc. Variable costs are those incurred in making a sale, e.g. a product and associated costs like freight inwards, packaging etc. If you're selling a service it's labour and materials on the job.

When you've calculated variable costs per product or job you then calculate gross margin. For example if a product costs \$40 (including all costs associated with getting the product ready for sale) and you're selling it for \$100, gross margin is 60%.

Now you need to know fixed costs. Let's say they are \$30,000 per month. To work out break-even sales - take fixed costs of \$30,000 divided by gross margin of 60%, which gives a figure of \$50,000. This is your monthly break-even total sales figure. If your average product sale is \$100, divide the total sales break-even figure of \$50,000 by your average sale of \$100, to come up with a figure of 500 units to breakeven. In simple language this means you have to sell 500 units per month at \$100 to break-even.

Now you know your break-even, use this as a basis for setting targets to achieve your desired profit. For example: with every additional unit you sell above the break-even volume of 500 units, you will make \$60 profit, which is the gross margin per unit of sale. Therefore if you target to make \$6000 profit, you will need to sell an additional 100 units.

07

UNDERSTAND THE 'CASH FLOW CYCLE'

This diagram shows

- ▶ On day one we buy in stock to sell
- ▶ On day 101 we sell the stock – it's not uncommon for items to sit in store for this long waiting to be sold
- ▶ On day 46 we pay for the stock, having had 45 days credit from the supplier
- ▶ This gives us 55 days negative cash flow from payment for the stock to sale of the stock
- ▶ On day 217 we get paid by the customer for the sale, having given 116 days credit (not difficult and uncommon where no customer payment follow up process is in place)
- ▶ This creates another 116 days negative cash flow, from sale of stock to receipt of payment from the customer
- ▶ You can see from this diagram that it takes 171 Days from when the goods are paid for until the customer pays for them. This means that the cash has to come from somewhere to fund these sales. This means that someone else has got your cash for 171 days until you collect it from your customer. That is your supplier or your customer.
- ▶ To improve this situation and relieve cash flow stress you need to:
 - a. Reduce the time stock sits in store waiting to be sold, with a stock management system or 'just in time' stock method
 - b. Increase the time taken to pay suppliers, by negotiating better payment terms with them or shopping around
 - c. Reduce the time your customers are taking to pay, by implementing good invoicing and collection processes
 - d. Reduce time to finish jobs so you can invoice quicker.

08

CREATE STRONG PROFITABILITY AND CASH FLOW BY MANAGING 'THE 7 KEY NUMBERS THAT DRIVE PROFIT AND CASH FLOW'

a. Sales Levels/Revenue Growth

Business owners focus a lot on sales – they say “Let’s make more sales and profit will look after itself...”

... yes, winning a job is important, but what is just as important is how much that job costs you to make and costs you to fund.

Have a plan on how you are going to maintain/grow your sales revenue:

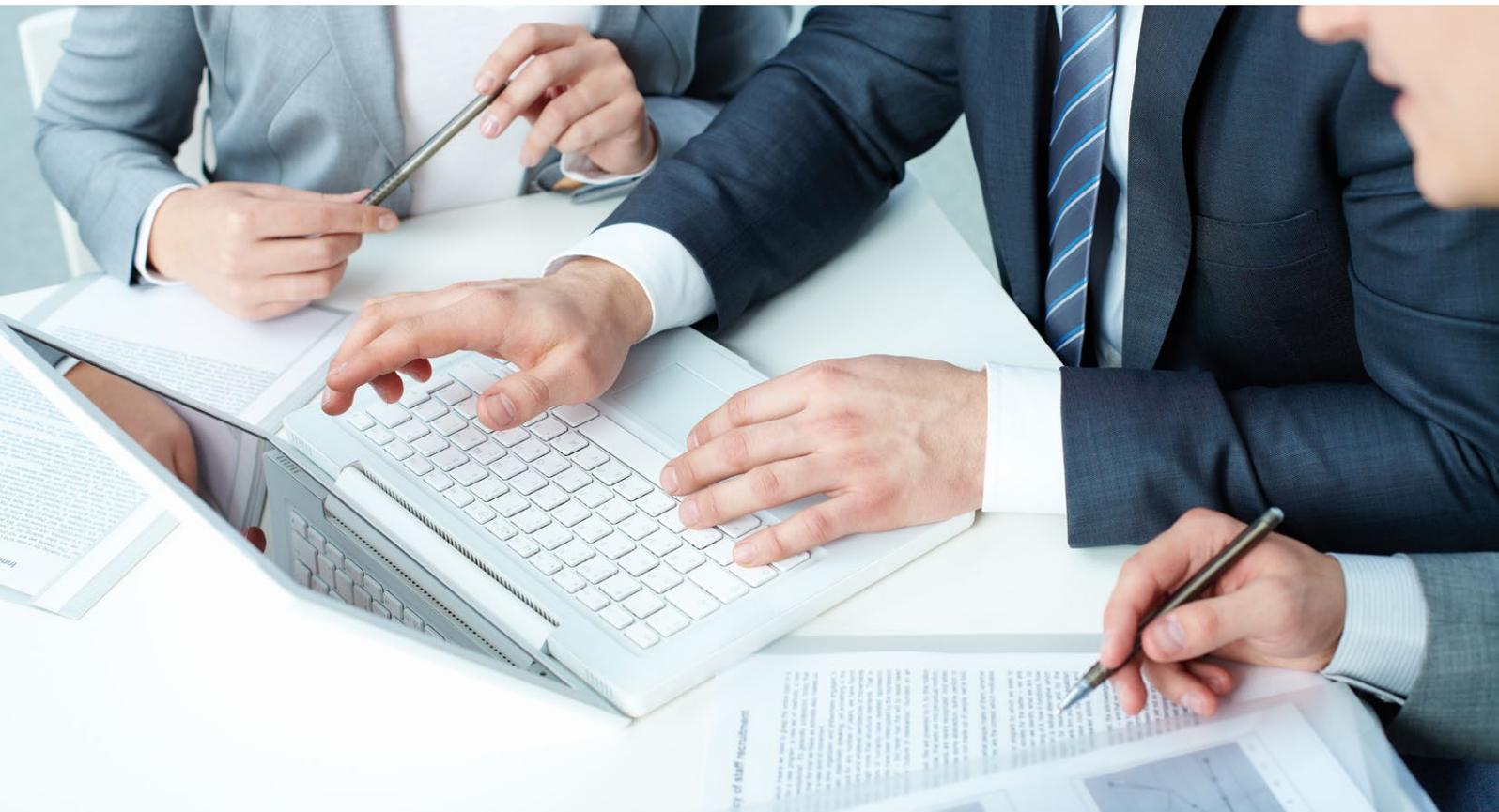
- ▶ Measure your Revenue drivers against budget:
- ▶ Salesperson, advertising spend, product offering etc.
- ▶ If these drivers are varying from your budget change things to suit:

Change your salesperson, change your advertising spend, change your product/job groups.

b. Cost of your Product or Service

Reducing the cost of your product or service can be done in a number of ways:

- ▶ Negotiate with suppliers
- ▶ Look at alternative materials
- ▶ Focus on direct labour costs – scheduling, overtime, outsourcing or capital investment.
- ▶ Better systems/processes to improve efficiency
- ▶ These tactics can often have a bigger impact on profit than increased volume/price!



c. Reduce Overheads

This is just a bit of hard-nosed cost control and needs to happen in well run businesses from time to time.

Overheads are often a cost of the business that is not challenged. This is done by:

- ▶ Looking at your costs on a line-by-line basis – priority given to the largest overheads, which is usually staff and occupancy.
- ▶ Challenging the necessity of each cost item
 - ❑ Is it necessary?
 - ❑ Is it excessive?
 - ❑ Is it increasing/decreasing?
 - ❑ Could we do it more efficiently?

Cut 'Fat' not 'Muscle' e.g. don't stop marketing or get rid of good staff.



d. Improve Customer Payments

Your business should not be financing your customers' business.

Handling customer payments is one of those systemic issues that must be done on a regular basis – normally weekly.

This would involve

- ▶ Reviewing your outstanding accounts
- ▶ Establishing a collection strategy
- ▶ Invoicing ASAP
- ▶ Collecting outstanding monies
- ▶ Identifying problem customers
- ▶ Reviewing your Terms and Conditions
- ▶ Possibly establishing a settlement discount policy (ensuring it doesn't eat up all your profit)

A common mistake is not putting due dates on invoices.



e. Reduce Inventory and/or Work in Progress

In many industries inventory levels and your level of uninvoiced work (Work in Progress) are major issues.

Improvement in this area is normally done by:

- ▶ Look at stock levels and value by item
 - ❑ Looking at the sale/usage levels for these items
 - ❑ Establishing strategies to remove old stock from the business
- ▶ Look at the value of uninvoiced work
 - ❑ Do your contracts take into account the cash flow of the project?
 - ❑ Ensure future contracts are structured to take this into account (or even structured cash flow positive) i.e. time deposits and progress payments in line with payments to service staff and suppliers
 - ❑ Ensure systems are in place to enable this to be maintained in the future
 - ❑ Finish jobs ASAP, so they can be invoiced

Stick excess stock on EBay for sale

Try to structure your contracts to ensure only minimal payments are left on completion of the job.



f. Review your pricing

This does not need to be a published price or an increase to all your customers.

There are numerous ways prices can be increased without necessarily damaging your reputation or business.

This is normally done by:

- ▶ Looking at the pricing of each product, service or product group
- ▶ Reviewing the sales levels of these services, products or groups
- ▶ Looking at the cost of these services and products
- ▶ Identifying the best and worst products in terms of profitability
- ▶ Implementing a pricing strategy or system
- ▶ This could include a structured pricing strategy based on Customer Type or Service Offering to ensure your best customers/services are promoted and your less profitable customers/services may need a higher price increase.
- ▶ Do it regularly – small often is better than large infrequently.

If you're worried about customers leaving – ask yourself “Where will they go?”

Use the opportunity to promote your ‘Unique Selling Proposition’ – what makes you different, the value of the services you provide.

g. Review your Supplier Payments

This is also an area of your business that can result in a big improvement in your bank account balance.

This is normally done by:

- ▶ Looking at your payment terms with your suppliers
- ▶ Ensuring these terms match the cash flow of your projects
- ▶ If they do not:
 - Sit down with your supplier and explain your cash cycle
 - Work out a way these can be matched – increased payment terms for different products or alternative products that may suit you and your supplier’s business better.

Biggest mistake people make is being too efficient, paying people too early and not using all the terms available.

Seek a more collaborative type of relationship with your key suppliers... an increase in your business will also have a positive impact on theirs.



Summary of the 7 Key Numbers

- ▶ Almost every business owner can make small improvements to each of the 7 Key Numbers in their business.
- ▶ Each small improvement to the right numbers, often by as little as 1% or 2% when calculated together, can have a massive impact on total cash flow and profit.
- ▶ A typical poorly managed business (financially) with revenues of around \$1m could realistically:
 - Improve annual profit by \$50-\$60K
 - Improve cash flow by around \$100K



09

DO WHAT SUCCESSFUL BUSINESSES DO

- a. They have a Business Plan and a Budget (A Financial Road Map)
- b. They are systematic
- c. They measure their performance – monthly at a minimum
- d. If their measurements do not meet their plans and budgets, they make changes to their business
- e. And largely because of this...
- f. They have strong profitability
- g. They have strong cash flow

Setting goals is only part of the journey. A business must always adjust and aim to develop flexibility to respond to challenges and opportunity.

A budget is one key to a greater understanding of your business and allows for flexibility.



CFO On Call Offer To You

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A 'Financial Roadmap'
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Just one hour with a CFO could
make a big difference to your
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**Discover the 'Power of
an Hour' with a CFO**



In 1991, **Sue Hirst** and Stuart Frost saw that while many small businesses had the support of an accountant, they weren't receiving forward-thinking financial control or advice on business efficiency. Business owners were making critical decisions based on accounts that could be up to 18 months old.

They believed small business owners could achieve more, with less stress and at a fraction of the cost, if they could access the services of an experienced Chief Financial Officer (CFO) or Financial Controller on a part-time basis.

And so Computer Accounting Doctor (CAD) was born. Initially to help businesses move into computer-based accounting systems, they developed tools, health checks and methodology to help business owners understand what their numbers actually mean.

As **CFO On-Call** it became the largest on-call or part-time Financial Control and CFO service business in Australia and New Zealand.

CFOs understand what it means to be in business, and can make a tangible difference to the success of your business - financially, operationally and commercially.

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