BEER MAT MENTORING MEETING NOTES

(5) Cash flow

Is your cunning plan viable? This boils down to (1) do you have enough cash? And (2) will the business be profitable? These are not the same: fast growing companies have a nasty tendency to run out of cash and therefore go bust even though they are making a profit.

Go with the flow

You need a cash flow forecast. This is a best guess at what your business bank account statements will look like in the coming months. It's different from a simple list of your income and costs because it takes into account WHEN you will pay and be paid; and it has a monthly opening and closing BALANCE.

Producing a cash flow is easiest if you are familiar with Excel. Search germinate.net for the free cash flow template.

In the first column, write "opening balance". Under this, list all sources of income and total income underneath; then list costs with a total underneath. Then add "cash flow in month" (total income minus total cost). The final row is the "closing balance" (opening balance plus income less costs).

Label the next column as month 1, the first month you start buying things for the business. Put an opening balance of zero at the top of the column. In the next row, put in estimated income, including only the money you expect to bank that month. Which may be zilch: even if you sell stuff in month 1, your customer might not pay until month 2 or 3. Then add your costs, but only if the money will actually leave your bank account that month. Your cash flow and closing balance are probably negative. Transfer the closing balance to the opening balance at top of the next (month 2) column and repeat for month 2.

Do you need to take an income out of the business? If so, include this in your costs. If you can manage without for a while, then just draw your income from profits when these start to materialise. I worked half time, for free, for three years, in my first significant business. It paid off later.

Normally, cash flow closing balances for a start-up are increasingly negative. Then - if the business is profitable - the negative balance starts to reduce, and eventually the balance is increasingly positive.

How negative is your worst month? This amount – and add more as a safety margin – is what you need to start the business. Is it a realistic amount for you to invest, beg or borrow? If you are paying interest, add the interest payment to your cash flow costs, so the total you need to borrow will be higher.

Fat profits?

To work out if your business is profitable, there's one more cost to consider: equipment replacement costs (depreciation). It is unlikely to affect initial cash flow, but it affects profitability. How long will each item of equipment last? What is the cost of replacement? How much should you therefore set aside each month to replace your equipment?

Now, take your monthly revenue and deduct operating costs, loan costs, salary and depreciation. Will there be any money left? If not, don't panic (yet). Are there any other income streams you can generate? Are there any costs you can reduce: for example, can you buy second hand, rent or borrow equipment? Can you reduce the loan amount you need by obtaining customer payments earlier or paying suppliers later?

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