Advice:

Why Monitoring Your Cash Flow is Critical Right Now

ARTICLE CO-WRITTEN BY: JEFFREY SIMPSON, CFA, CHIEF COMMERCIAL OFFICER, UMASSFIVE COLLEGE CREDIT UNION, & JEFFREY SATTLER, SVP COMMERCIAL BANKING, LIBERTY BANK

It's an unfortunate fact—most small and middle market businesses in our community will experience negative cash flow in response to the COVID-19 virus and the related economic downturn. As a result, business owners must take immediate action to anticipate their business cash flow and liquidity needs over the next 90-120 days. A daily/weekly/monthly cash flow forecast, though an admittedly arduous task, has become an emergency life raft, and necessary tool in these times.

Cash flow assessment is an enlightening process that disciplines the owner, management, and employees alike to critically evaluate expenses, and determine where reductions can be immediately made. It challenges areas of cost and expense reduction that may have been previously overlooked, and can inspire new ideas and practices that will make your company stronger in the long run. Most critically, it facilitates proactivity, and brings difficult decisions into the conversation before your business finds itself in a position where it cannot support anyone: employees, vendors, or owners.

The Process:

This exercise should include daily, weekly, or monthly tracking of actual cash balances against a forecasted expectation for cash balances. Begin by recording on a daily, weekly, or monthly basis actual beginning cash balances, actual cash receipts, actual cash expenditures, and actual ending cash balances against a forecast of the same cash categories. The forecasted beginning balance, forecasted cash receipts, forecasted cash expenditures, and forecasted ending balance should include your best assessment of the impact revenue declines, expense increases, slower collections, and vendor payments may have on your cash balances.

The Results:

By tracking actual cash flows against forecasted cash flows on a daily, weekly, or monthly basis, your company can now review developing trends, anticipate their impact, and take actions that will maintain and perhaps exceed your forecasted cash flow expectations. As time passes, the insights generated from the actual vs forecasted cash flow exercise will become more meaningful. Based on trends in the data, the company should modify the forecast, compare expectations to actual cash balances, and take concrete steps to mitigate negative trends. Note that the cash flow forecast need only be directionally correct; it will not be perfect. If diligently prepared each day, week, or month with the information you have available to you, it will be "good enough" to make optimum business decisions during these difficult and unpredictable times.

Being prepared to generate additional liquidity outside of normal operations is just good business. Every company in every industry has their own cash flow challenges. However, without a conservative and well thought out cash flow plan, a business will not be able access cash quickly enough to meet required operating costs, payroll expenses, as well as the "unexpected". Options to increase cash flow and liquidity include reducing expenses, increasing receivable collections, discounting sales of obsolete or slow moving inventory, investing additional equity capital, accessing government sources, and if necessary (assuming your business is in position to do so), increasing borrowing through a bank, credit union and/or the SBA.

Knowledge is Power

Financial institutions are great resources during difficult times, but they must also be prudent when lending out depositors money. Most consumer and commercial loans are made with monies borrowed from the checking, money market, savings accounts, and certificates of deposit accounts of its depositors. They are restricted by regulation and their fiduciary responsibilities to depositors to make prudent loans that protect and preserve the cash balances of their depositors. The fact is that no financial institution can or should make a loan to a business that cannot demonstrate it understands, and is in control of, its own cash position. With the assistance of cash flow analysis, management is better prepared to assess and demonstrate to the lender how much the company needs to fund short-term liquidity requirements, as well as determine whether the business, under normal economic conditions, has the cash generating capacity to repay any loans they assume today.

By demonstrating working knowledge of your current and future cash position, a financial institution may be more likely to consider your business for a loan.

It is always better to be proactive with your decisions, rather than sitting back and hoping things will improve. If financing is a necessary course of action for your business, you should know that the federal government just passed into law a bill that includes disaster relief financing through the US Small Business Administration. Businesses should apply directly to the SBA for loans up to $2 million that includes subsidized interest at 3.75% and loan amortizations of up to 25 years. The first three months require no principal or interest payment, and if the original loan is not enough to carry your business through the recession, you can re-apply for additional funds.

As an experienced businessperson, you may feel you can "go with your gut" and do just fine. Maybe you're right. As long as we are in unchartered waters, however, the more prudent course is to validate "gut instincts" with concrete facts and good information. This is particularly important if you expect assistance along the way from a financial institution, investor, the government, or friends and family—all of whom should ask for proof that you understand your cash position, and financial condition, before parting with their dollars. ***Our advice? Start with the cash flow! It can give you—and others—the answers to a number of questions, and offers a head-start charting the unknowns of tomorrow.***

UMASSFIVE
Commercial Services Division

UMassFive's Commercial Services Division is strategically comprised of business owners, so when it comes time to make crucial decisions, we're in your corner with informed advice that comes from hands-on experience.

Contact our business expert Jeffrey Simpson, CFA
umassfive.coop/business • 413.256.5560