

# Understanding Your Cash Flow and How to Optimize Your Financial Data

The COVID-19 pandemic has wreaked havoc across businesses and economic markets around the globe. Businesses are facing unprecedented obstacles that put increasing pressure on cash flow and operations. Businesses must understand their cash flow and be able to rely on their financial data in order to make accurate business decisions.

## Understanding your cash flow

In the months and even years prior to this pandemic, businesses were managed by the bottom line. Put another way, profits and shareholder returns were the defining measurements of a successful business. Now, due to social restrictions, supply chain disruptions, and market chaos—all caused by the COVID-19 pandemic—organizations must pay special attention to cash management to sustain and drive their business to recovery. To do this, **businesses must understand their cash flow.**

Ideas to consider when dissecting your cash flow:

- 1. Have intimate knowledge of your existing business operations.** Consider how your business is being specifically impacted by the pandemic. How are revenue streams being impacted? Are you experiencing supply chain issues? What is the outlook for your business after the pandemic?
- 2. Understand your customers' situation.** As you evaluate your revenue stream, consider how your customers are being impacted by the pandemic. Does your business cater to an industry that is embattled by the COVID-19 pandemic (e.g., hospitality, healthcare, restaurants)? If so, are you planning for a decline in demand? What are the short-term and long-term impacts on your customers' buying habits? Will customers request extended payment terms, make fewer orders but with a higher product volume, or a higher number of orders with less product volume per order?
- 3. Understand your cost structure.** Separate variable costs and fixed costs. Variable costs typically include cost of sales, supplies, travel, employee wages, et cetera. Fixed costs include debt payments, salaries, rent, et cetera. Consider opportunities to negotiate fixed costs to variable terms. This will give you more control over your cost structure.
- 4. Understand your vendors and supply chain.** As you consider your business and the demand for your products or services, consider those key vendors upon whom you are reliant. How are they being impacted by the pandemic? Is your business' cash flow heavily reliant upon one or two key vendors? Does this pandemic create an opportunity to negotiate more favorable pricing or delivery terms?
- 5. Understand your labor costs.** Labor is the largest expense for many businesses. It's likely that your staffing and labor structure has been under new pressure due to the pandemic. In analyzing your labor costs, separate contract labor and employee labor. If your goal is to reduce costs but retain employees, consider reducing contract labor and shifting those duties to existing employees. Analyze the cash requirements of hourly wages and look for ways to reduce hours or redistribute tasks to maximize the efficiency of the hour. For some salaried or key employee positions, consider offering future equity for salary reductions. Identify non-labor compensation (paid parking, travel, meals) and make necessary adjustments.

Many businesses have endured labor reductions due to the COVID-19 pandemic. As businesses look to bring employees back to work, they should do so in stages. Businesses need to be sensitive to the fact that it may take several months for the impacts of the pandemic to dissipate. Businesses should match anticipated increases in demand with the return of their workforce. Proper planning should be in place to bring back key roles at appropriate times to begin to rebuild employee infrastructure for the post-pandemic business.

- 6. Understand the financing and capital positions.** Evaluate all your cash inflow options by reviewing your business' access to additional capital. Work with your bank to extend borrowing capacity or renegotiate terms that may free up cash. Consider any key stakeholders who are able and willing to make an additional contribution of funds into the business for increased equity in the business.

# Understanding Your Cash Flow and How to Optimize Your Financial Data

## Look ahead: cash flow forecasts

Once a business understands its cash flow, we suggest building operational forecasts. These forecasts should include multiple scenarios that will test the strength of the business' financial position. These scenarios should factor in many of the considerations discussed above and should range from best-case to worst-case.

The forecasting process should be perpetual. The scenarios embedded in each forecast should be updated with new internal data (actual results) and external data (regulatory, jobless claims, geographical data, et cetera).

Businesses need to develop both long-term and short-term forecasts. A suggested best practice would be to have a three- to five-year long-term forecast that is updated as needed. A long-term forecast gives the business insight into the long-term implications of decisions made today. Short-term rolling forecasts of 12 to 15 weeks focusing on receipts and disbursements will serve as a powerful tool to help manage daily operations. The short-term forecast should be updated weekly.

## Understanding your operations: optimizing financial data

Managing cash flows is paramount to the success of a business. Many businesses build structures to manage cash flows, develop forecasts, and eloquently communicate how cash came into the business and how it was used. Businesses often understand the **when** and **how** of their cash flow, but lack clarity into the **why**. Additional data is often needed to drive change and better business decisions in real time. This additional data may consist of financial ratios calculated from data found on a balance sheet or income statement. However, businesses can achieve a deeper understanding by capturing non-financial data to blend with financial data for a more thorough operational analysis.

Optimizing financial data may consist of tools that track key financial ratios or key performance indicators (KPIs) that are essential to decision-making. KPIs vary by industry and by company. Businesses seeking deeper insight into their operations should customize the KPIs that are most important in their decision-making process and build systems to gather the necessary data.

Potential KPIs include:

### **Financial based**

- » Cash balance
- » Current ratio
- » Days in accounts receivable
- » Accounts payable aging
- » Profit margin %
- » Inventory turnover ratio
- » Overhead expense/revenue

### **Financial and non-financial based**

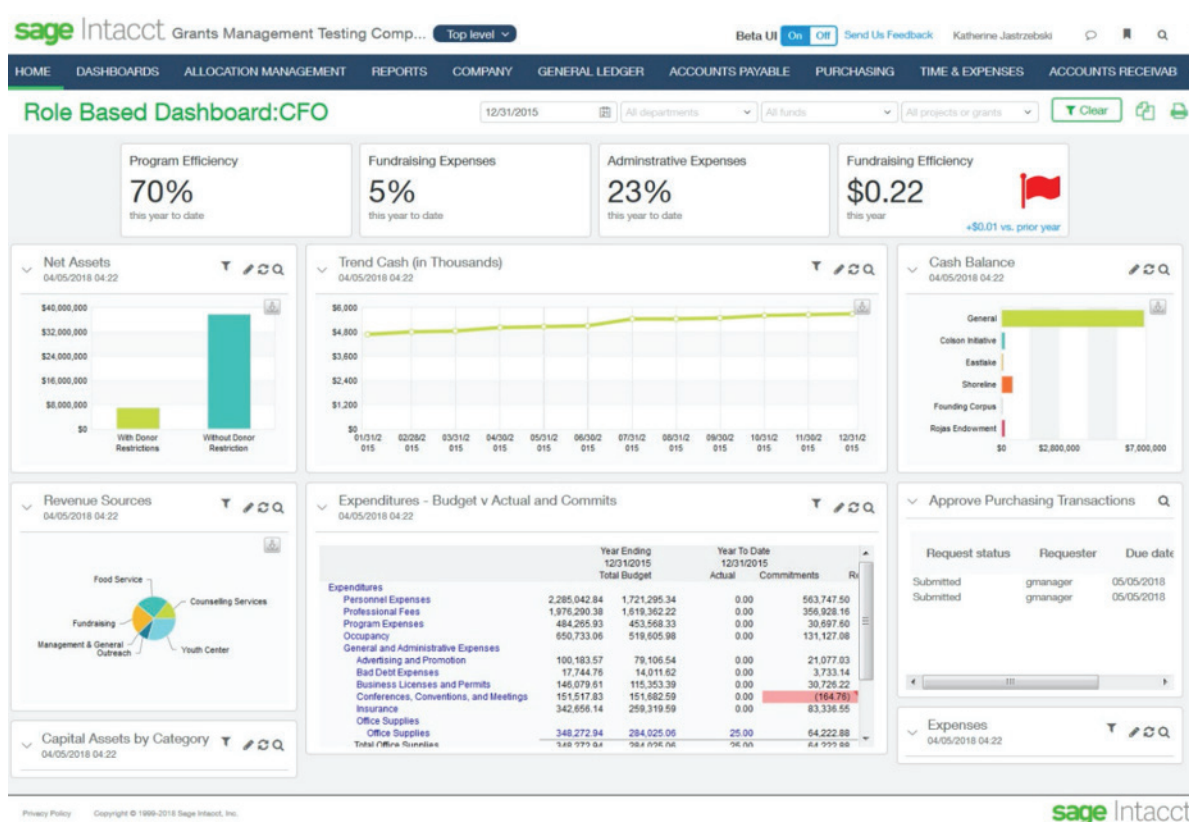
- » Sales by location by product by salesperson
- » Number of customers per day of week
- » Number of customers per salesperson
- » Average gross profit per project manager
- » Average sales per customer
- » Average wage per hour per project
- » Net collections per physician

# Understanding Your Cash Flow and How to Optimize Your Financial Data

## Understanding your operations: optimizing financial data

Automation is key when building a system to monitor KPIs, as it allows data to be collected efficiently and accurately. Multiple systems may be used to gather information and then transmit relevant information into a centralized source for calculating KPIs. KPIs are then made available on a user dashboard within the accounting or enterprise resource planning (ERP) system. A dashboard is a customized report that provides users quick access to key data and it is only as valuable as the information it reports. A best practice is for dashboard data to be live data that reflects current operations (not last month). Additionally, users should have the ability to drill down into their dashboard to obtain transactional details.

There are a number of ERP systems that allow users to build dashboards containing KPIs that track financial and non-financial data. Sage Intacct is an ERP that we at Dean Dorton are very familiar with and use for many of our outsourced accounting engagements. Below is a dashboard generated within Sage Intacct.



Understanding cash flow and optimizing financial data both require a thorough understanding of current and future operations. Many times, this may require a harsh honesty. Businesses with the ability to identify the key data points that drive cash flow and influence operations will be positioned to react to changing business demands and maximize value.

## CONTACT US



Justin Hubbard [jhubbard@deandorton.com](mailto:jhubbard@deandorton.com)  
Krista Nash [knash@deandorton.com](mailto:knash@deandorton.com)

# DEANDORTON

Lexington ■ Louisville ■ Raleigh ■ [deandorton.com](http://deandorton.com)