

How to Improve Your Cash Flow During Inflationary Times

7 min read



In inflationary times, cash is king.

Key Takeaways

- **What Is Risk Management?:** Risk management is the practice of identifying, evaluating, and taking action to control or mitigate the risks that could potentially...
- **How to Manage Risk:** Once a potential risk has been identified, the next step is to analyze and assess the potential threat to your...
- **Always Be Prepared to Safeguard Your Business From Risk:** To help protect your business and ensure that risk-related losses cannot seriously harm your business, you should always...

By now, you've likely personally felt its effect on your own bank account, grocery bills, and gas runs.

If you're paying attention to your business's expenses, you have probably already noticed how inflation is affecting your budget, spending plans, and cash flow.

To really understand how inflation affects your business and what you can do to improve your cash flow during difficult economic times, you first need to understand a bit about inflation and the current state of the U.S. economy.

What Is Inflation?

Inflation Definition: The term "inflation" refers to price increases resulting from the diminished purchasing power of a country's currency over time. Inflation is typically expressed as a percentage that describes the rate at which prices are increasing compared to previous periods ^[1].

Inflation typically occurs when the growth of a country's money supply outpaces the growth of its economy or when supply is significantly lower than demand.

Inflation, Recession, and the Current State of the U.S. Economy

The U.S.'s current supply chain issues have resulted in a significant inflationary gap (the difference between the amount of demand and the available supply). Additionally, the U.S. gross domestic product (GDP) has also shrunk over two consecutive quarters. When an economy experiences at least six months of contraction, this is typically considered an economic recession.

Despite the attempts of Federal Reserve Bank officials to stymie increasing inflation with two consecutive 75-point interest rate hikes, the result of all these economic factors is that inflation is currently through the roof. A 40-year high inflation rate of 9.1% was reported at the end of June 2022 ^[2].

How Inflation Impacts Business Cash Flow

Increasing Prices

The direct result of inflation is that your business's cash has less spending power than it did before. This means that the expenses you budgeted for at the beginning of the year are to be higher than anticipated, resulting in unexpectedly high costs.

Increasing Loan Interest Rates

In addition to prices going up everywhere, the Federal Reserve Bank has also announced two consecutive interest rate hikes in an attempt to slow inflation. If you need to take out new financing or have current loans with adjustable or variable interest rates, then you'll start feeling the effects of inflation in higher loan payments, as well.

Cash Flow Shortages

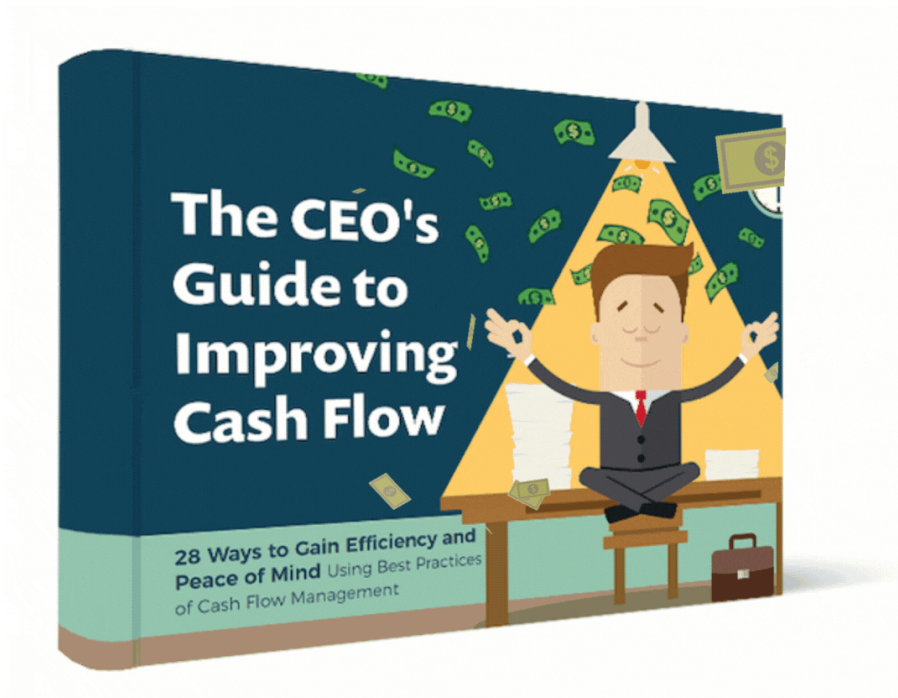
All of this adds up to a major crunch on your company's cash flow. If you started the year with a comfortable budget, you might be finding yourself now operating on a shoestring budget that doesn't leave room for error or for inflation to continue through the rest of the

year. Worst-case scenario, you're already experiencing a cash flow shortage that needs to be remedied and a future cash flow emergency that needs your attention right now.

Accounting for Inflation and Tips for Improving Business Cash Flow

Unfortunately, inflation and fairly unstable economic times are once again a reality in the United States. As a business leader, it's necessary to recognize that the time to start reacting and planning for financial challenges is now.

Take a look at your accounting processes to make adjustments that can shed a brighter light on the impact of inflation on your costs, revenue, and profits. Additionally, you should be taking a fine-toothed comb to your operations to identify your most profitable activities while cutting unnecessary expenses, unprofitable clients, products, and services.



Inflation Accounting

During inflationary times, it's smart to work with your finance function to implement inflation accounting which makes adjustments on all of your financial statements to account for the current inflation rate.

The two most common methods are current purchasing power (CPP) and current cost accounting (CCA). Whichever method you choose to implement in your [back office](#), it will give you and the rest of your company's leadership team a clearer picture of the actual expenses and purchasing power in your business in light of inflation.

Read More: [The Impact of Turnover and Inflation on Business Owners](#)

Unit Economics

When inflation rates are high and show no signs of slowing, you have to keep a close watch on your costs, but even more importantly on your profit margins.

Make sure your accounting department is using unit economics to individually track the profit margins on a variety of client types (or each individual client), job types, services, and products.

By watching these profit margins closely, you'll be able to see which revenue channels in your business are performing best under the pressure of inflation in addition to tracking which ones are suffering significantly with increasing costs. As a result, you can focus on those that are performing best and either adjust the operations for underperforming revenue channels or decide to eliminate them altogether.

Price Optimization

Now is the time to optimize your prices to account for increasing costs. Prices are increasing everywhere, so none of your customers will be surprised that, as a result of inflation, you also need to increase your prices. As you adjust your prices, remember to focus on your business's unique value proposition and why you're worth every penny you ask for.

Read More: [You Can't Fix Your Pricing Problem Without Doing THIS First](#)

Effective Accounts Receivable Management

Cash flow isn't just about the amount of money coming in and out of your business but also the timing of when it flows in and when it flows back out. You can improve your cash flow by improving when and how you get paid.

Stay on top of collections. Renegotiate payment terms with clients who pay slowly, cut ties with clients that repeatedly don't pay on time, and offer your clients more ways to pay (electronic payments online or ACH collections) to improve repayment compliance.

Track your results by watching your day's sales outstanding key performance indicator.

Cost Analysis

Perform a thorough cost analysis of all your business operations, products, and services. Which materials have gone up in price the most? Have these prices increased equally across the board or are you doing business with a vendor who disproportionately increased their prices?

Capital Structure Analysis

Additionally, take a look at the capital structure of your business. Assess all of your current debt, including the payment amounts and interest rates (and whether any of these rates are variable). Consider how much you have in cash reserves and determine whether any of these loans need to be paid off right away or if you should sit with the debt for a while so that you can hold onto your existing cash reserves in the event of a cash flow emergency.

Employee Retention Strategy

In addition to protecting your cash flow with financially-minded strategic approaches, you should also have a human-capital-minded approach to saving money, too. Improving employee retention will have a hugely positive impact on your cash flow because the cost of employee turnover is surprisingly significant.

Read More: [Why Employee Retention Is Important And How To Improve It](#)

Instead of spending a major amount of money on replacing employees who have quit, invest a portion of that money into your employees. Invest in employee training and

professional development in addition to morale boosters and motivators like employee recognition, compensation, and benefits.

Want to Survive the Next Recession? Protect Your Profit Margins and Keep a Close Eye on Cash Flow

Cash flow shortages are the most common reason why businesses fail. In inflationary times and times of economic recession, cash flow shortages become increasingly prevalent. So, it's essential that you protect your business from this very serious threat.

To keep a close eye on your cash flow, you need to be checking your cash flow statements routinely while also actively forecasting with three, six, and twelve-month trailing cash flow charts. This can give you a better feel for cash flow trends that occur in your company. By considering these trends in light of the present economic challenges, you should be able to get a fairly accurate idea of your business's upcoming cash flow issues. If you detect any concerning signs of a potential cash flow shortage, take action in the present to create a plan that will see you through the upcoming challenges.

Additionally, protecting your profit margins is also protecting your cash flow. Remember that you can't sell your way to profits. Unprofitable products, services, or clients will always be unprofitable – no matter how much you sell. Keep a close eye on your increasing costs and how they affect margins on all types of clients, services, jobs, and products your business deals with. If you notice a trend of shrinking margins in any area, either take action to pad your profit margins or consider eliminating the clients, products, jobs, or services that don't generate strong profit margins for your company.

By strategically maintaining a healthy cash flow in your business, you and your business can survive these inflationary times and the next economic recession. Plus, you might find that you and your company emerge from these trying times even stronger for having learned how to survive.