The Seven Drivers of Cash Flow

6 min read

When reviewing your financial data, there are a lot of variables to take into consideration. So how do you analyze the numbers to determine the most important factors?

Key Takeaways

- **Cash Flow In Your Business:** Cash is the lifeblood that courses through the veins of an organization, dictating its ability to navigate challenges, seize opportunities, and ultimately thrive in a dynamic market…
- **Price Change Percentage:** The price change percentage is any fluctuation in price. It can include a price increase or decrease, or a temporary discount…
- **How Outsourced Accounting Can Help With Your Cash Flow:** Outsourced accounting can be a lifeline for businesses seeking to bolster their cash flow management…

As cash flow is crucial to business success, looking at what drives your business's cash flow is an excellent start. There are seven key financial drivers for cash flow. Each driver provides unique information that, when analyzed together, can help you identify areas to improve cash flow, reduce financial waste, and make smarter, strategic business decisions.

What is Cash Flow In Your Business?

Cash is the lifeblood that courses through the veins of an organization, dictating its ability to navigate challenges, seize opportunities, and ultimately thrive in a dynamic market.

Whether you're a seasoned entrepreneur or just stepping into the realm of business ownership, understanding the nuances of cash flow is essential for steering your ship through calm waters and stormy seas alike

The 7 Drivers Of Cash Flow

1. Accounts Receivable Days

Accounts receivable days are the number of days (on average) that it takes a customer to pay, assuming that payment is made on credit terms. This term can be easily confused with terms offered. The term of repayment may be 30 days, in that a customer has 30 days to pay their invoice in full. However, customers don't always pay on time.

So even though the term for repayment is 30 days, the number of accounts receivable days can be much longer.

The discrepancy between when an invoice is created and when it is paid in full can severely impact a business's cash flow.

2. Accounts Payables Days

Accounts payable days are the number of days (on average) that it takes to pay a vendor or supplier. For example, an office supply company may provide coffee on a monthly basis for a company. The office supply company (the vendor) may set payment terms for 30 days. This means that the company has 30 days to pay the invoice in full. Unlike accounts receivable, vendors and suppliers are usually paid out faster than the cash flows into a business, which can create a cash squeeze.

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If a company has to spend all of its available cash on suppliers while waiting for customer payments to come in, they can only operate at a limited level without any cash reserve in the bank.

3. Work In Progress Days

For product-based organizations, the inventory days are the number of days (on average) that products sit in stock before being sold. For a service-based organization, work in progress days are the days between which wages and materials are paid for and when the job is finished and invoiced.

One way to improve cash flow here is to streamline the job management process. **Optimizing workflow on a job reduces the number of work in progress days, which positively impacts cash flow.** Additionally, when a job is completed early, it improves customer satisfaction – a mighty incentive for the client to pay for the job faster.

This next group of drivers focuses on specific percentages that have a major impact on your business. Even slight variations in percentages can either boost your bottom line or ruin your business's cash flow:

4. Price Change Percentage

The price change percentage is any fluctuation in price. It can include a price increase or decrease, or a temporary discount. Thanks to the variable cost of living and inflation, you can't sell a product or a service at the same price for years and still be profitable. Cash flow and profits are not the same, but they are deeply connected.

There are also things that are nearly impossible to predict, such as a spike in fuel prices or an increase in food prices. Your company needs to be able to accommodate for these variations, which is why it is so important to monitor your margins. **If you see your profit margins shrinking, it might be time to reevaluate your rates.**

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5. Revenue Growth Percentage

Logically speaking, one way to increase cash flow is to sell more, right? Actually, increasing sales can sometimes exacerbate your cash flow problems. Sales require money. You need to pay to produce the product and maintain it in stock while also paying for labor to sell the product.

For service oriented businesses, an increase in sales means increasing the number of hours required to complete the new jobs. Remember, there is no guaranteed that you will get paid by the customer right away.

You need to have enough cash in the bank to cover the costs of your labor and operating expenses. If you're already running low on resources, boosting sales can actually decrease your cash flow drastically.

6. Cost of Goods SOLD (COGs) Percentage

The costs of goods sold (or cost of services) is essentially all of the costs that are directly associated with producing a product or delivering a service. Reducing the costs of goods sold directly impacts your bottom line.

Steps to reduce your COGS can include buying materials in bulk, negotiating with suppliers, and reducing waste. Of all of the seven cash flow drivers, cost of goods sold has the most impact.

Even if you are able to reduce your COGS by just 1%, you will notice a significant change in your bottom line.

7. Overhead Percentage

Overhead are costs that occur each month and include rent, Internet service, light, power, and even payroll. Even though these expenses happen on a monthly basis, it doesn’t mean they are the same from month to month. An unseasonably warm summer or cold winter can quickly drive up an electric bill.

On the flip side, a particularly successful month for your sales team means a larger-than-expected payout come commission time. In order to keep your overhead percentage in check (which improves cash flow) you need to **track your budget**.

Monitoring your actuals versus budget for overhead keeps your overheads percentage stable and allows you to better budget for operating costs in the future.

Cash flow works differently for every company, but one truth remains universal: you can’t manage what you can’t measure.

Improving cash flow management is the key to unlocking your business’s potential – it’s what leads to making the right decisions, and gaining the right clients.

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How Outsourced Accounting Can Help With Your Cash Flow

Outsourced accounting can be a lifeline for businesses seeking to bolster their cash flow management. By entrusting financial tasks to industry professionals, companies can benefit from their expertise in optimizing cash flow drivers like accounts receivable and accounts payable days. Outsourcing also provides access to advanced financial software and technologies, streamlining processes and reducing errors that can otherwise impede cash flow.

Outsourced accounting offers cost-efficiency by eliminating the need for in-house accounting teams and providing scalable solutions that match a business's evolving needs. Ultimately, outsourcing accounting functions not only enhances financial transparency but also frees up valuable time and resources, enabling companies to focus on core operations and strategic growth, all of which contribute to a healthier cash flow.