**Questions About My Company's Cash Flow:**

**Creative Agencies**



Cash flow is the lifeblood of any business, and creative agencies are no exception. A healthy cash flow allows companies to pay bills on time, invest in new technology or marketing initiatives, and take care of their employees. Conversely, a cash flow crisis can lead to layoffs, missed payments, and bankruptcy.

Several things can cause a cash flow crisis for a creative agency. Simplified, the two essential components are receivables and payables. For example, collecting payments from clients late can wreak havoc on your cash flow, as can a need for more planning when paying your bills.

Fortunately, you can take steps today to get on top of your numbers and minimize the risk of experiencing a cash flow crisis.

Let's answer some common questions creative agency owners have about cash flow and its management.

**Understanding Cash Flow**

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**What's the difference between cash flow and profit?**

The profit of a business is the revenue it generates minus the expenses it incurs.

On the other hand, cash flow is the actual cash coming in and going out of the business over time. Timing is the crucial element that makes cash Flow so important.

Understanding the difference between profit and cash flow is essential because they sometimes move in tandem. A business can be profitable but still, experience a cash flow crisis if it isn't generating enough cash to meet its obligations.

**How does cash flow affect my business?**

Cash flow directly affects a business's ability to operate. A company needs cash to pay its bills, invest in new products or services, and, most importantly, pay staff salaries. If a business doesn't have enough cash, it will eventually have to close its doors, which is why cash flow is often referred to as the lifeblood of a business.

**How does a company get into negative cash flow?**

Many things can cause a company to have negative cash flow, but the most common culprits are a loss of business, late payments from clients, and a lack of planning when paying its bills.

What's important is to have a clear idea of the break-even point for your agency's cash flow so you know the minimum amount of cash that needs to come in every month to keep the lights on and salaries paid.

**What is a cash flow statement?**

A cash flow statement summarizes a company's inflows and outflows of cash over some time, typically on a monthly or quarterly basis. The statement shows how much cash the company has on hand at the beginning of the period, how much it has generated or used during that time, and how much it has at the end.

A cash flow statement is a good insight into a company's health because it provides visibility into the sources and uses of cash and lets you keep an eye on trends over time.

Note that a cash flow statement is considered one of the three most important reports that will be produced by a financial professional (Accountant, Bookkeeper, CFO). Still, it must be understood that it is a product of the past.

**Forecasting Cash Flow**

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**What is cash flow forecasting?**

Cash flow forecasting estimates a company's future inflows and outflows of cash. It's a vital tool for managing cash flow because it allows businesses to anticipate potential or unavoidable shortfalls and take steps to avoid them. A cash flow forecast should include all sources of revenue and all expenses, fixed and variable, and should be updated regularly as new information becomes available.

A cash flow forecast is more important to a company than a cash flow statement because it is more important to look through the windshield of a car than the rearview mirror.

**What are the benefits of cash flow forecasting?**

Cash flow forecasting has several advantages, but the most important is that it can help businesses avoid a cash flow crisis. By forecasting cash flow, you can see potential shortfalls and take steps to prevent them, such as by delaying non-essential expenditures or by seeking short-term financing.

That's why it's crucial to have a good grip on your cash flow situation from today and start preparing for a rainy day instead of waiting for a crisis to happen when it is already too late to take action.

**What are the challenges of cash flow forecasting?**

The most common challenge regarding cash flow forecasting is that it can take time to predict future inflows and outflows with 100% accuracy. Even if you have a perfect overview of the expected payment dates for every single invoice, there's always the possibility that a client will pay late or that an unexpected expense will pop up.

That's why it's crucial to build a buffer when forecasting cash flow and to have a contingency plan in place for when things don't go as expected.

**How do I understand my customer risk?**

For a creative agency, one of the most important things to understand is customer risk. Risk is the likelihood that a customer will not pay their invoices on time or at all. To assess customer risk, you need to look at several factors, such as reviewing the payment history for each customer and identifying any late or missed payments.

Another way is to review the creditworthiness of each customer using a credit scoring model. This mechanism will give you an idea of how likely each customer could default on their future payment.

For new customers or those with high credit risk, consider requiring a deposit or prepayment before starting your work as part of your standard payment terms.

**Improving cash flow**

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**How can I get my clients to pay me sooner?**

Many companies need more time between the time they deliver their project and when they receive payment from the customer. This can strain your cash flow, especially if you have other expenses that need to be paid.

To reduce this payment delay, you must ensure that you're invoicing your customers promptly. If your invoicing is inefficient, consider automating it to make it easier. You can also optimize your payment terms to get paid sooner.

**How can I optimize my payment terms?**

Before coming up with the payment terms you're going to offer your customers, you must understand the cash flow needs of your agency. For example, if you have many expenses that need to be paid upfront, consider offering your customers shorter payment terms so you get paid sooner.

For most agencies that do creative work, such as advertising or public relations, the largest bucket of expenses is usually labor costs, so consider billing your customers every month rather than after the completion of a project. You can spread out your costs and improve your cash flow.

**How many months of buffer do I need in my cash flow?**

The amount of buffer in your cash flow forecast depends on several factors, such as the nature of your projects, payment terms, and revenue stability. If you have variable expenses or seasonal income, you'll need a larger buffer to account for these fluctuations. You should have enough cash to cover 3-6 months of operating expenses. This will give you a cushion to cover unexpected costs or sales drops.

**Are there any quick ways to improve my cash flow in the short term?**

If you're looking for a quick cash injection, you can do a few things.

* One option is to offer your clients **discounts for early payment** of invoices that have already gone out. This will incentivize your customers to pay their invoices before the due date.
* It's also a good idea to have a few aces up your sleeves prepared in advance that you can put in place quickly, such as a **pre-approved line of credit or business loan** that you can tap into if needed.
* You can also offer a few **easy-to-execute services on short notice**, such as consultation calls, branding audits, or seasonal social media graphics, to sell and charge quickly.

You have a few options if you ever need to generate some quick cash. In addition, having a few things in your back pocket will help weather any unexpected cash flow crunches resulting from unforeseen expenses or slow sales.

**What are the long-term solutions to improve my agency's cash flow?**

If you want to improve your agency's cash flow in the long term, here are a few things you can do.

* **Review your pricing** and ensure you're charging enough for your services, significantly if you last increased them a while ago and salaries and cost of living have gone up.
* **Offer additional services with a higher profit margin**, such as coaching or consulting, to which you can upsell your clients.
* **Sit down with your team and think** about new ways to add value to your clients so that you can become their preferred agency and charge a premium for your services.
* **Review your client portfolio** and ensure you're not overloaded with low-paying clients that are eating into your profitability or late-paying clients, causing cash flow uncertainty. Then, if you need to, let go of some of these clients so that you can focus on the ones that are more profitable and have better payment terms.
* **Make sure you're staying on top of your invoicing and collections** to get paid on time.
* **Try to create a balanced portfolio of clients** that combines project work with long-term contracts, giving you a steadier stream of revenue. However, be careful, as contracts can still be canceled or put on hold, so don't rely on them too heavily.

**How do I improve my collections process?**

You can do a few things to improve your collections process, but the first step is to make sure you have a clear collections strategy, to begin with. These are some basics that you should include:

* **Set clear payment terms** with your clients from the start. Make sure they know when you expect them to pay and the consequences of late payments. Payment terms should be included in the client contract and on every invoice you send.
* **Track invoices and payments** so you can follow up quickly on any overdue ones. Send reminders before an invoice is due and after it's outstanding. You can easily automate this process with billing software that will send out reminders for you.
* **Consider offering early payment discounts**, incentivizing your clients to pay their invoices promptly. Of course, this will reduce your profit, but it might be worth it so you can get paid sooner.
* **Establish late fees for overdue invoices** and enforce them. It's essential to set the expectation that there will be consequences for not paying on time. Ensure you're clear about this so clients know the situation. You can make exceptions on a case-by-case basis to maintain good customer relations in exceptional circumstances.
* **Consider using a collections agency** for delinquent invoices. This can be costly as they can take a percentage of the amount owed, but it may be worth getting your invoices paid and recouping some of the money that's owed to you.
* **Decide when to take legal action against a client** to get them to pay an overdue invoice. This should be a last resort, as it's costly and time-consuming, but it may be your only option if all other attempts to collect payment have failed.

**Is it worth it to have a line of credit?**

A line of credit can be a valuable tool for small business owners, providing access to funds when you need them. It's a specific type of loan where you're given a credit limit that you can borrow against and pay back over time, with interest.

The terms of a line of credit will vary depending on the lender, but typically, you'll only be required to pay interest on the amount you've borrowed and not the entire credit limit. This can make lines of credit more flexible than other types of loans, which makes it perfect for managing your cash flow, as you have the money there already approved when and if you need it.

However, there are also some potential downsides to having a line of credit. For example, it can be tempting to overspend if you have access to more money than you need, which is why it's essential to be disciplined when using a line of credit and to request only the amount you estimate could be necessary.

Another downside is that lines of credit tend to have higher interest rates than other types of loans, so you'll want to be sure that you use it for short-term needs and pay it back as quickly as possible to avoid accruing too much interest. They should be used only for short-term expenses or to help with cash flow management to cover gaps in income if you have a slow month.

**Managing Negative Cash Flow**

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**What are some red flags that my company is heading for a cash flow crisis?**

If you have a solid plan in place for forecasting and managing your cash flow, you should be able to avoid any significant problems. However, here are a few red flags to watch out for that could indicate your company is heading for a cash flow crisis:

* **Your sales are going down**. This could be a temporary dip, but if it continues, it will eventually impact your cash flow. In a creative agency where the most significant expense is your payroll, a prolonged drop in sales can be devastating, so it's essential to take action quickly if you see this happening.
* **You need to get paid on time**. Even if your sales are thriving, if you're not getting paid promptly, it can still strain your cash flow. This is why it's so important to have a solid collections policy and invoice tracking in place.
* **Your expenses are growing faster than your sales.** When your agency is growing, and you're in a position to hire new talent, it can be tempting to overstaff your team, hoping that will let you take on more clients. However, if your expenses are growing too quickly, it can cause problems down the road. So make sure you're only hiring when necessary and that your staff is fully utilized before you bring on more people.
* **You have more debt than you can handle.** Debt serves a purpose, but if you're relying on it to cover the month-to-month costs of running your business, it's a sign that your cash flow should be better. Unfortunately, excessive debt can make it challenging to get new loans or lines of credit when needed and adds to your expenses.
* **You need to maintain a healthy cash reserve.** A cash reserve is like a safety net for your business. If you don't have one or are consistently using it, it's a sign that your cash flow needs attention.
* **You're consistently dipping into your line of credit to make ends meet**. Unfortunately, this shows that you need to generate more revenue to cover your monthly costs. If you're using your line of credit to pay for operating expenses, it's time to take a closer look at your business model and find ways to generate more revenue.

**What can I do if I can't cover my monthly expenses?**

Ideally, you want to focus on prevention to stay within the point where you can cover your monthly expenses. However, if you find yourself in this situation, there are a few things that you can do:

* **Review your expenses** and see if there's anything you can cut back on with immediate effect.
* **Talk to your creditors or suppliers** and see if they can give you some leeway with extended payment deadlines. That's why building good relationships and trust with them is essential, so they're more likely to work with you when you're in a tight spot.
* **Talk to your clients** and see if they can pay outstanding invoices early. This can be a tough conversation, but if you've built up a good relationship with your clients, they may be willing to help you out.
* **Look into short-term loans or lines of credit** from banks or other financial institutions. These can be helpful to get you out of trouble, but you need to pay them back quickly to avoid accruing too much interest. Credit cards should only be used as a last resort, as the interest rates are usually very high.
* **Downsizing your business** or letting go of some staff will always be difficult, especially if you've built up a great team that you're proud of. But if it's the only way to keep your business afloat, it may be necessary. Before taking this step, it's vital to understand if your cash flow problem is just a temporary blip, in which case you should do everything you can to weather the storm or if it's a more structural issue that downsizing may help to solve.

Running a creative agency is never easy and can be incredibly challenging when facing a cash flow crisis. However, if you're proactive in forecasting your cash flow and take steps to prevent such a situation from happening in the first place, you will avoid most cash flow problems. And if you find yourself in a tight spot, you will already have clear options to help you get back on track by acting quickly before the problem snowballs, letting you keep your business running smoothly.

These tips will help you keep your agency on track. And remember, profit is good, but cash flow is king.

