

EPISODE 2

Solving the Cash Flow Problem

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Overview

- What is Cash Flow and what drives cash flow?
- What is Cash Flow planning?
- When is your business Cash Flow positive/negative?
- Why Cash Flow planning is so important?
- How to set up your Cash Flow forecast?
- Cash Flow KPIs (DSO, DPO, Burn Rate, Cash Runway, AR Ageing, CEI)
- Discussion on Cash Flow Key Topics:
 - ✓ Common mistakes in cash flow forecasting.
 - ✓ How to use the output of your Cash Flow Planning and KPIs?
 - ✓ How to avoid cash flow problems?
 - ✓ Improving your cash collections is key to maximize cash runway!
 - ✓ High Cash Burn Rate can be acceptable by Investors
- How does it all look in **farseer**?
- Q&A

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What is cash flow and what drives cash flow?

CASH IN (Revenue + Financing) - CASH OUT (Costs)

Drivers:

➤ **Amount**

- ✓ Initial Cash balance
- ✓ Amounts of cash in and cash out flows
- ✓ Growth of revenue, financing, or costs

➤ **Timing**

- ✓ Payment terms
- ✓ Cash collection rate

What is cash flow planning?

- Cash flow planning is not only about forecasting **HOW MUCH** (revenue, financing and cost), but also **WHEN** (we expect to receive revenue/financing or pay cost).
- Cash flow problems can be caused by **timing of payments**.
- It's about **having enough cash** to operate the business **at any given time!**

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When is your business cash flow positive?

CASH IN > CASH OUT

- At a given point in time
- Positive cash flow (or cash surplus) can be used to accelerate growth!

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When is your business cash flow negative?

CASH IN < CASH OUT

- At a given point in time (usually measured monthly)
- Negative cash flow (or cash burn): amount spend from initial cash balance
- Cash Runway: Number of months it will take us to run out of cash, with the current rate of Cash Burn. (=Initial Cash Balance/Monthly Cash Burn Rate)

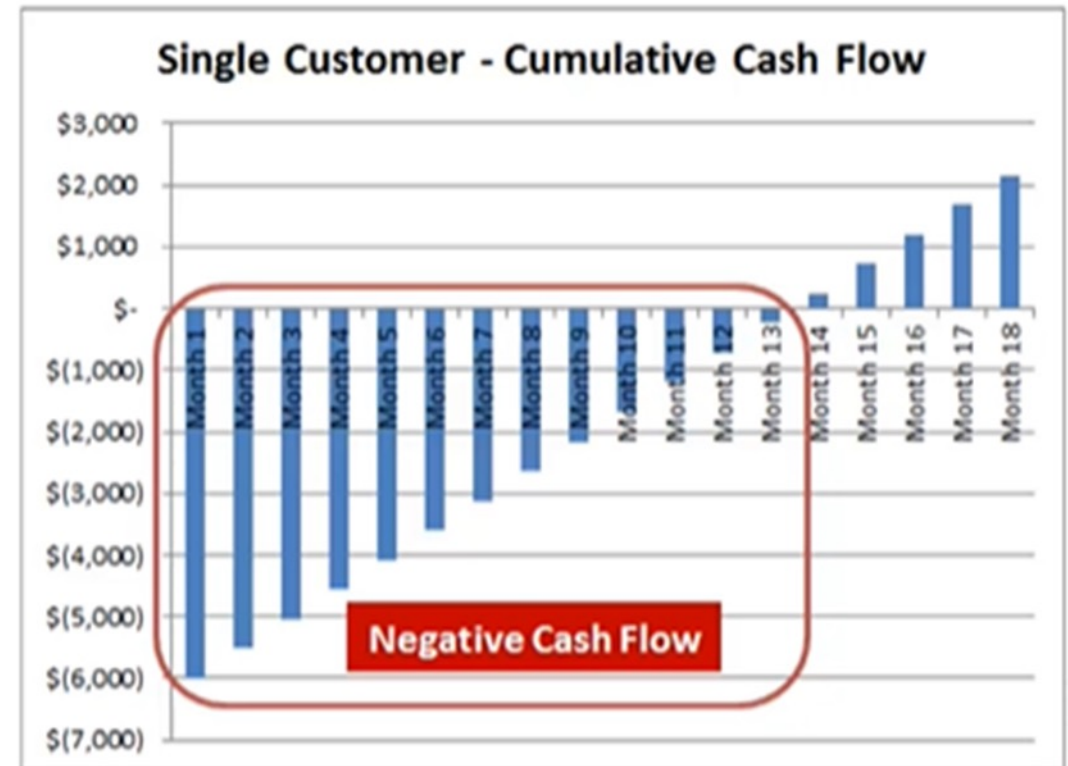
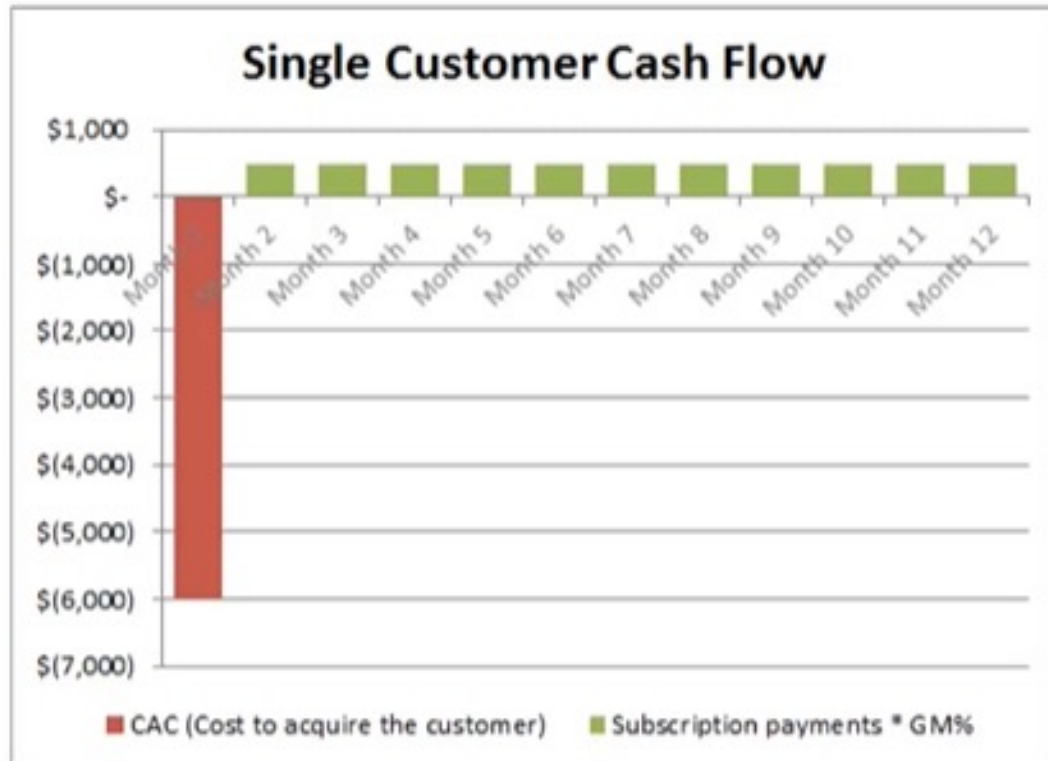
Why cash flow planning is so important?

- One of the top reasons that startups fail is **lack of cash**.
- Do we have enough cash to reach next financing round, or revenue milestone?



Why cash flow planning is so important?

- Due to the subscription model, it takes time to recover Customer Acquisition Cost (CAC).
- MRR is not the same as the cash in your bank account
- **Remember:** in a SaaS model, customer churn means losing all expected future cash flows from churned customers immediately!



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How to set up your Cash Flow Forecast?



How to set up your Cash Flow Forecast: List Sources of Cash In

➤ **Cash from operations:**

- ✓ Cash from Existing subscription contracts (Accounts Receivable information)
- ✓ Cash Projection from future renewals of contracts/terms (Consider Churn).
- ✓ Cash Projection from new contracts (new sales/contracts – consider conversion).
- ✓ Cash projection on Non-recurring revenue

➤ **Financing:**

- ✓ Loans (bank loans, equity loans, corporate bonds sold to investors, peer-to-peer loans)
- ✓ Government or private grants or financial support programs for businesses
- ✓ Investors

➤ **Investing:** sale of assets, or interest from assets

How to set up your Cash Flow Forecast: List Sources of Cash In

- Apply revenue **segmentation** by region, customer, product, salesperson etc
- Clearly defined Revenue Streams/Categories, product types
- Segmentation allows for more accurate assumptions on specific customer cash flows

REVENUE		Jan-21	Feb-21
Region A			
Customer A			
Product A			
Number of units sold			
Average selling price per unit			
Product B			
Number of units sold			
Average selling price per unit			
Customer B			
Product C			
Number of units sold			
Average selling price per unit			
Region B			
Customer C			
Product B			
Number of units sold			
Average selling price per unit			

Cash in Assumptions: How to forecast amount and timing of revenue?

- List all potential sources of revenue in detail.
- Consider servicable market research and benchmarking to similar business.
- Start with existing subscription contracts and past performance
- Analyze your Sales Pipeline, potential reach and Conversion Rates (probability of a new customer)
- Measure the probability of subscription renewals. (customer satisfaction)
- Consider add-on sales.
- Do not forget to include churn.
- Consider capacity to support growth and risk factors
- Be conservative
- Decide how far you want to forecast in the future.
- **When you expect to get cash in your bank from forecasted revenue: use contractual payment terms**
- **Consider cash collection rate (historical payment behavior)**

Cash in Assumptions: How to forecast amount and timing of cash from financing & investors?

- Research sources of available financing and related terms/requirements.
- Benchmark against market data.
- Use for scenarios (base, worst, best):
 - ✓ How different (realistically attainable) financing options would affect cash balance over time?
 - ✓ Given current revenue and expenses projections, payment terms and cash runway, how much financing is needed and when is it needed?
- Cash from investors: linked to achieving milestones?
- Forecast timing when you need it or when it is likely to achieve, based on scenarios

How to set up your Cash Flow Forecast: List Sources of Cash Out

Costs of Sales

- Hosting
- Payroll engineering and support personnel (salaries,taxes,benefits,travel)
- Merchant/Partner fees
- Subcontractor fees
- Software and tools cost
- Any other product development & support costs

Operating Expenses (OPEX)

Sales & Marketing

- Advertising & related marketing activities
- Promotional events
- Payroll Sales and Marketing personnel (salaries,taxes,benefits,travel)
- Subcontractor fees
- Software and tools cost

Engineering (R&D only)

- Subcontractor fees
- Software and tools cost
- Payroll (salaries,taxes,benefits,travel,etc)

General & Admin (Overhead)

- Subcontractor fees
- Software and tools cost
- Payroll (salaries,taxes, benefits,travel)

CAPEX & Non – Operating Costs

Other non operating expenses

CAPEX: Asset Purchases and Sales

- Equipment,furniture,offices
- Investment in other entities or ventures.

Loans and Funding

- Loans (capital, interest)
- Investor Funds (capital, dividends)

Tax

- Sales tax/VAT collected
- Sales tax/VAT payments to government
- Corporation Income Tax

Cash out Assumptions: How to forecast cost?

- Make a detailed list of all possible costs.
- Consider cash runway, zero cash date, projected revenue and profitability targets
- Consider costs that grow with number of customers/employees
- Trends on Employee salaries, average cost of products and services, accounting and tax regulations
- Detailed view for near future and top-level aggregated view for periods > 6 months.
- Always budget for risks if possible.
- **When do you expect to pay your suppliers for these expenses with cash out of your bank: use contractual payment terms and historical payment behavior.**

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How does it come together: the Cash Flow statement.

	Jan-21	Feb-21	Mar-21
Cash In	Cash In		
	Cash from sales		
	Cash collected from debtors		
	Other income		
	Cash from Loans		
Cash Out	Cash from Investors (Equity sale)		
	Total Cash Inflow		
	Cash out for cost of sales		
	Purchases/Materials		
	Licences		
	Hosting		
	Online payment costs		
	Other		
	Total Cost of sales		
	Cash out for Expenses		
	Salaries		
	Lease payments		
	Commissions		
	Repairs & Maintenance		
	Office supplies equipment		
	Advertising & promotions		
	Travelling		
	Accounting		
	Legal		
	Professional services		
	Rent		
	Telephone		
	Internet		
	Utilities		
	Insurance		
	Other Expenses		
	Interest on loans		
	Bank charges		
	VAT+ & VAT-		
	Company income tax		
	Total Cash Expenses		
	Cash Capital payments		
	Dividends		
	Loan repayments		
	Assets purchased		
	Owner cash withdrawals		
	Total Cash Capital payments		
	Total cash outflow		
	Opening Balance		
	Net cash receipts/expenses		
	Closing Balance		

Cash			
	2021	2022	2023
Cash from operations	-685.583	-2.403.932	-3.085.831
Cash in	41.257	938.612	1.412.673
Cash out	726.840	3.342.544	4.498.504
Cash from investing	0	240.000	480.000
Cash from financing	1.000.000	5.468.000	8.000.000
Net cash	314.417	2.824.068	4.434.169

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Cash Flow KPIs

\$23,685

Deposits: \$10,000

+5.2% (\$456)

ADD FUNDS



Goal: \$55,000

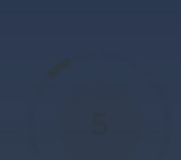
Duration: 4y

HISTORY

All time



PROJECT RISK



Balanced
Change your risk

Nr
AWS 2455

Created
22 Dec 2013

Download overall report

Allocation

Geo



Europe

45%

DETAILS

Show list



Europe

Qty
45%

Valorisation
\$72.80

Profit
+35.2%

Cash Flow KPIs

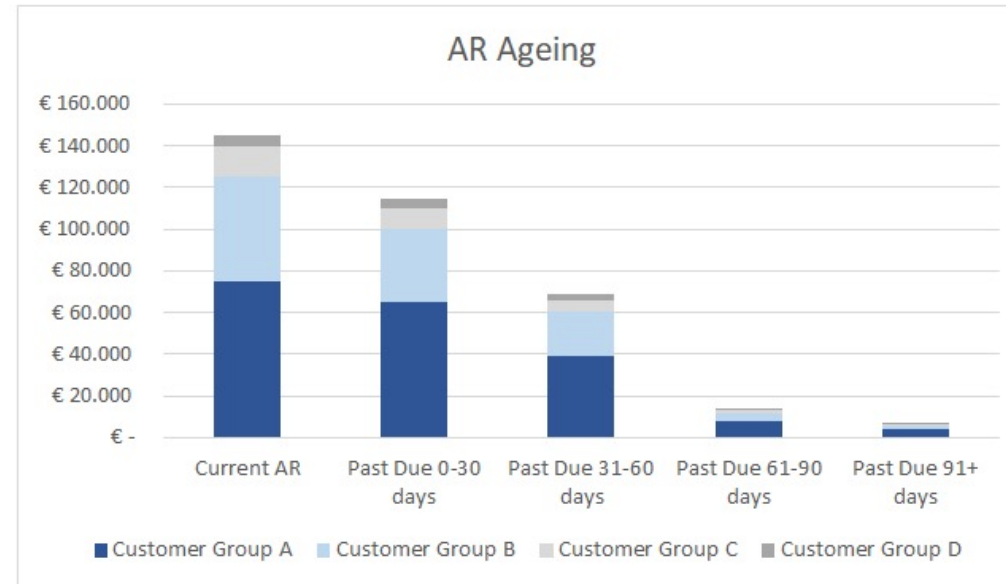
- **Accounts Receivable:** Revenue that we have not received yet from services provided.
- **DSO:** How many days it takes to get paid.
(Accounts Receivable/ Revenue)* (# of days)
- **Accounts Payable:** Cost that we have not received yet from services received.
- **DPO:** How many days it takes us to get pay vendors.
(Accounts Payable/ Cost)* (# of days)
- **Ending Cash balance:**
Starting Cash Balance + (Monthly Revenue - Monthly Receivables) – (Monthly Cost)
- **Cash Burn:** Ending – Starting Cash Balance
- **Cash Runway Months:** Number of months it will take us to run out of cash, with the current rate of cash burn.

XYZ Company Metrics		Jan-21	Feb-21	Mar-21	3M Avg
Cash Flow Metrics	Starting Cash Balance	300.000	284.000	267.820	283.940
	Total Monthly Revenue	7.000	7.140	7.283	7.141
	Accounts Receivable	3.000	3.570	3.641	3.404
	DSO	13	15	15	14
	Total Monthly Cost	25.000	25.250	25.503	25.251
	Accounts Payable	5.000	5.500	5.501	5.334
	DPO	6	7	6	6
	Ending Cash Balance	284.000	267.820	251.460	267.760
	Cash Burn	- 16.000	- 16.180	- 16.360	- 16.180
	Cash Runway Months	19	18	16	18

- Improve your Payment Terms: Get paid earlier - Pay later
- Incentivize sales to bring in yearly prepayment contracts .
- Track trends

Receivables Aging

- **Current AR:** Accounts Receivable in line with payment terms and not yet overdue.
- **Past Due # days:** Receivables that are still not be paid # days after due date of payment terms
- **Actions:** Update weekly, follow up risk exposure/disputes/collections, add comments, act on overdue items.
- **Update forecast:** Past performance on overdue payments can be used on Cash Flow forecasting



Customer	Current AR	Past Due 0-30 days	Past Due 31-60 days	Past Due 61-90 days	Past Due 91+ days	Total AR	% Overdue
Customer Group A	75.000	65.250	39.150	7.830	3.915	191.145	61%
Customer Group B	50.000	35.000	21.000	4.200	2.100	112.300	55%
Customer Group C	15.000	9.750	5.850	1.170	585	32.355	54%
Customer Group D	5.000	4.750	2.850	570	285	13.455	63%

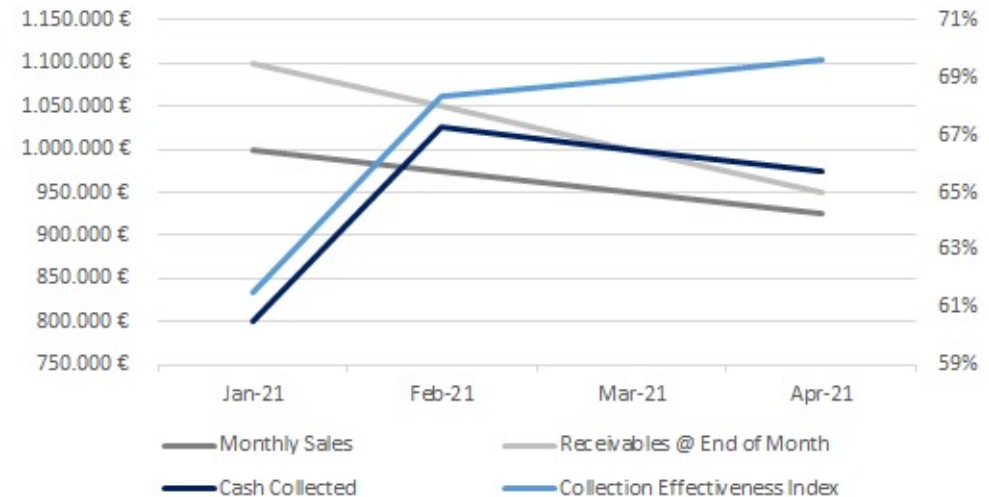
Collections Effectiveness Index (CEI)

- **CEI:** the percentage of the collected amount of money within a given time period, over the total amount of money owed to the company in that same period.
- ✓ **How strong current collections processes are?** (top score is 100%: all money is collected within period)
- ✓ Can be measured over time, or per collector.
- ✓ Despite drop of revenue, increased collections effectiveness can decrease Cash Burn Rate!

$$\frac{\text{Receivables @ start of month} + \text{Monthly Credit Sales} - \text{Receivables @ end of month}}{\text{Receivables @ start of month} + \text{Monthly Credit Sales} - \text{Receivables Not Overdue @ end of month}} \times 100$$

Month	Receivables @ Start of Month	Monthly Sales	Receivables @ End of Month	Receivables Not Overdue @ End of Month	Collection Effectiveness Index	Cash Collected
Jan-21	900.000	1.000.000	1.100.000	600.000	62%	800.000
Feb-21	1.100.000	975.000	1.050.000	575.000	68%	1.025.000
Mar-21	1.050.000	950.000	1.000.000	550.000	69%	1.000.000
Apr-21	1.000.000	925.000	950.000	525.000	70%	975.000

CEI over time



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Cash Flow Key Topics

Common mistakes in Cash Flow Planning

- Timing confusion (When does your money actually come in and when does it go out?)
- Over-optimism (Always assuming the best case)
- Not considering cash collection delays
- Forgetting growth in costs
- Lack of detail / hidden costs
- Not updating the cash flow model regularly enough!
- Not tracking Receivables regularly enough!

How to use Cash Flow Planning output and KPIs?

- **Look at the numbers. Does it make sense?**
- **Consider different scenarios based on drivers and make manual adjustments:**
 - ✓ Cash collection or cash payment timing adjustments
 - ✓ Different hiring or spending scenarios
 - ✓ Funding scenarios
 - ✓ Alternative forms of cash inflow, or even new business models
- **Make business decisions:**
 - ✓ Keep track of overdue payments
 - ✓ Modify Payment terms with customers and suppliers
 - ✓ Modify spending plans
 - ✓ Seek (additional or different) funding
 - ✓ Link scenarios to decisions

How to avoid Cash Flow problems?

- **Remain focused on your current stage of growth and development targets.** Trying to do everything all at once will result in high burn and reduced runway.
- **Be aware of your market dynamics and sales cycles.** For example, if you're a B2B business, winning customers may take longer than expected and result in delayed cash flows.
- **Be aware of delays between expenses and revenue**
- **Be aware of external market factors** (for example Covid19)
- **Operating cash flows:**
 - ✓ Improve conversion rate and customer retention
 - ✓ Favor contractors, over hiring directly (flexibility to cut costs, or increase production fast, if required)
 - ✓ Avoid hiring expensive employees too early.
- **Investing cash flows:** Rent/lease instead of buying. Capex is an unnecessary luxury for young companies.
- **Financing cash flows:** Be mindful of loan repayments.
- **Above all: Improve your payment terms and your collections effectiveness!**

Improving your cash collections is key to maximize cash runway!

- **Credit Policy:** Documented guidelines on credit sales, debtor management, dispute management tools, processes & owners
- Issue **correct invoices immediately after a credit sale** to prevent delays in payment. Be prepared to respond quickly to disputes.
- Maintain a complete **record of debtors**, outstanding and overdue invoices, and a history of debtor payments and communications. Group them by amount owed and risk level.
- **Overdue invoices:** Have a pre-designed, systematic and automated workflow for the immediate follow-up of overdue invoices.
- **Collections & Factoring:** Use third-party debt collection and legal services, if needed. It is not too expensive.
- **Reports:** track debtors. Overdue invoices, accounts receivable aging, overall cash flow.
- **Collecting money:** Innovate your payments policy by offering online payments, accepting credit cards, having incentives for early payments, and introducing progress payments.
- **Credit hold procedures:** Stop extending credit to serial late payers. Monitor high risk customers so you can jump in early to negotiate a collection before an adverse event occurs.
- **Prompt payments culture:** Aim for 100% timely collections. Start from larger customers, but don't ignore smaller debtors.
- Have separate, **dedicated bank account for receivables** and payables. This way it is easier to track payments.

High Cash Burn Rate can be acceptable by Investors

- Each stage in business development implies a certain number of employees and a certain level of operational costs, therefore an acceptable level of expenses and Cash Burn Rate.
 - ✓ Ideally, Cash Burn rate should result in a cash runway of at least 12 months
- **Build Trust with accurate cash planning and efficient management:**
 - ✓ Be near your forecast, to show you can control your cash burn as planned.
 - ✓ Show that big part of costs is variable, so adjustable if needed
 - ✓ Show you avoid unnecessary costs
 - ✓ Achieve key objectives in current development stage that were agreed as targets with investors
 - ✓ Show you achieve objectives without diluting their investment (limit funding rounds)
- Burn Rate is not easy to manipulate with accounting tricks, so investors trust it.

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How does it look in farseer?



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\$23,685

Deposits: \$10,000

+5.2% (\$456)

ADD FUNDS



Goal: \$55,000

Duration: 4y

HISTORY

All time

\$52,00
July 2021

2012

2013

2014

2016

2017

— Your balance

— Market value

--- Your deposits

PROJECT RISK

5

Balanced

Change your risk

Nr
AWS 2455

Created
22 Dec 2013

Download overall report

Allocation

Geo



• Europe

45%

DETAILS

Show list

Europe

45%

North America

35%

Japan, South Korea

10%

Others

10%

• Europe

Qty
45%

Valorisation
\$72.80

Profit
+35.2%

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Thank you for your time.

If you are interested in a product demo or a free consultation meeting, please contact:

consulting@farseer.io