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Introduction
Introduction

The COVID-19 pandemic has presented a massive challenge to businesses around the world.

It has forced businesses to look at a range of responses from diversifying markets and supply chains, to drastic cost cutting measures and the use of emergency funding and insurance facilities. With implications of this pandemic still unravelling, we are seeing catastrophic repercussions across economies and industries at large that are likely to be with us for some time.

Sectors like tourism, hospitality and entertainment have been particularly hard hit, but we are seeing businesses across most sectors experience negative effects with small to medium enterprises seeing the greatest impact. Many have been critically affected, transitioned into survival mode, or have ceased to exist altogether. As a startup, you’ll need to refocus your efforts on financial survivability to have a chance at thriving after the pandemic. To do that you’ll need the right tools to help you understand your cash flow and financial obligations to determine how you can quickly adapt to this new reality.

The toolkit will help you:

1. **Develop a clear cash forecast** that will help you identify your burn rate (how much cash you are spending each month), your runway (how many months you can operate before you run out of money), and where you need to adapt.

2. **Review all spending** to identify opportunities to extend your runway by eliminating, reducing or postponing some of your costs.

3. **Develop financial scenarios** that will help you plan for the best-case, normal, and worst case circumstances that result from this new business climate.

4. **Identify contingency measures** that your business can take in the event of each of these possible scenarios.
Case Study
Case Study

Throughout this toolkit we will refer to the example of Nazif Organik*, to illustrate how a social enterprise might respond to COVID-19 and apply the tools we will teach you here to ensure their financial survival.

*Business name and some details have been changed to protect privacy.
NAZIF ORGANIK

Nazif Organik Ltd grows organic mushrooms that it supplies to health-conscious hotels and grocery outlets. To do this, the enterprise mobilises women with disabilities or those who are supporting dependents with special needs, trains them on organic mushroom farming, provides credit for initial start-up capital for a small mushroom farm, and buys the produce for resale. The organisation’s farm produced approximately 300 kgs of mushroom per month with the growers producing another 200 kgs per month.

The enterprise sells the mushrooms at $20.00 per kg with the cost of farming and delivery to customers being 40% of the selling price ($8.00). The farm also looks to make at least 20% on the mushrooms it resells from the out-growers (the contracted farmers).

Due to the COVID-19 pandemic lockdown, all hotels and most of the organic grocery outlets have shut down. This has left the enterprise with over 1,000 kgs of organic mushrooms ready for sale, which is projected to double over the next month due to an addition of produce from a recently recruited (pre-COVID-19) ‘farming cohort’.

To survive, Nazif Organik has introduced a 50% salary cut on the top management staff and placed non-essential staff on unpaid leave with a 30% salary cut onwards for all staff members. The enterprise has also reviewed and introduced major cutbacks in expenses such as rent on warehouses, office expenses, and marketing costs, among others.

The enterprise has reactivated a potential partnership that had been shelved which involved the drying of mushrooms. Nazif Organik has accelerated the engagement and has started the process of drying mushrooms for preservation. Previously, Nazif Organik had been reluctant to enter the retail space, but with the closure of the major wholesale buyers, the enterprise has partnered with a home delivery start-up to make home deliveries of dried mushrooms.

Nazif Organik is keenly following the developments in the business environment and the advisories issued and has modified its short and medium-term plans to reflect the changing environment. The enterprise has opened a line of credit with the local bank to plug the cash flow gaps expected within the coming months. The enterprise is also engaging with the government on subsidies in utilities which would go a long way in reducing its electricity and water costs.
Understanding Cash Flow
Understanding Cash Flow

Cash flow simply represents the movement of money in and out of the business. Cash moves into the business in the form of sales, loans, or investments and moves out in the form of expenditures like payments to suppliers, loan repayments, rent/utilities payments, taxes and any capital expenditures like equipment.

If you can manage your cash flow well in a crisis, it can mean the difference between your business surviving or closing its doors for good. As a business owner, you need to understand the impact the reduced sales will have on your cash flow, what it will look like over the next 3, 6, 12 months, and how it impacts your cash reserve.

Therefore, to quickly and simply understand your cash flow, you need to compare money coming in versus money going out over a given period (usually monthly or quarterly).

\[
\text{Cash going out of the business} - \text{Cash coming into the business} = \text{Cash flow balance}
\]

(Sales, investments, loans etc) - (Payments to suppliers, salaries, utilities, loan repayments etc) = (Positive or negative cash flow)
You are cash flow positive when you have enough money to meet your financial obligations. It could also mean that the business has money to meet future obligations (to a certain extent), if no money comes through during the coming period. This is where you want to be!

For example, Nazif Organik started with $2,500 in cash at the beginning of the month. Their customers paid the business $10,000 for the mushrooms and the business paid $7,000 to suppliers, bills, and other expenses.

Good News: the business is cash flow positive with $5,500 in the bank at the end of the month.

You are cash flow negative when you do not have enough money to meet your financial obligations when they are due. This may not be a problem in the short run but if it becomes a trend, you will be forced to tap into cash reserves and may eventually run out of money. Running out of cash is the number one reason most startups fail and understanding your cash flow is one of the best ways to prevent that!

Let us say Nazif Organik started with $1,000 in the bank at the beginning of the month. They invoiced customers for $10,000 worth of mushrooms and paid $7,500 to suppliers, bills, and expenses but by the end of the month, the customers had only paid $5,000. The business is still waiting for the rest of the payments to come in.

In this case, Nazif Organik’s cash flow is negative: -$1,500 for the month.
Don't confuse profit with cash. Your business can make a profit one month but still end up in a cash flow negative position! Cashflow looks at actual cash (cash at hand or in the bank) coming into the business versus the financial obligations due for the same period. Profit on the other hand, compares sales and expenses for the period. Often, sales are in credit and paid later. Therefore, sales are only recognised in our cash flow calculations once they have been paid.

For example, if Nazif Organik made $10,000 in total sales and incurred $7,000 in total expenses for the month, the profit for that month would be $3,000. But if only $5,000 of the $10,000 was paid up sales then despite making a profit this month, the enterprise would be in a cash flow negative position at -$2,000.
SO CAN WE PREDICT BUSINESS SURVIVAL?

Once we start to map out our monthly cash flow over the course of the year, we can begin to get a picture of financial health. You first need to understand how much money your business spends in an average month (your cash burn rate) and then you need to work out how long your cash will last (your cash runway). Knowing your burn rate and runway, you can quickly make corrective decisions to either reduce your burn rate and/or extend your runway to survive. The goal of extending the runway is to sustain the business until the environment corrects itself to enable you to return to a level of stability.

For example: if the business is spending $10,000 every month but is only bringing in $1,000 monthly then its burn rate is $9,000 every month. If the business has $50,000 in its accounts, its cash runway is therefore five months (unless something changes). If revenues increase to $5,000 every month then its burn rate is reduced to $5,000 every month and its cash runway is 10 months.

If, by assessing our financial health with these tools, we realise we have a high burn rate and/or a short runway, we are going to have to make some quick adjustments if we want the business to survive. Financial planner and author Robert Pagliarini suggests reviewing all expenses using the PERK method:

- **POSTPONE**
- **ELIMINATE**
- **REDUCE**
- **KEEP**
Postpone (P) - Which of your expenses could you put off for another few months? Do you really need to invest in new office equipment or software this month? Can you renegotiate or postpone any loan repayments? For example, at ygap, we have postponed an investment into an interactive learning management software to further support the ventures in our program.

Eliminate (E) - Which of your expenses could you completely cut? This may include reviewing payroll and making those tough decisions to cut certain roles that are unnecessary or unsustainable during this time. It will also include reviewing all that discretionary spending, employee perks, etc. Do you really need a subscription to that magazine? Are you going to be using your team's entertainment or professional development budget at this time? For example, at ygap, we have eliminated our annual global strategy retreat, professional development and training opportunities and all international travel.
Reduce (R) - Now we want to identify those expenses that may still be essential but that we could reduce to give us some extra leeway. This may include reductions to salaries across the board, reducing your advertising budget, reviewing or consolidating your insurance policies, or just getting creative about how you can be more resourceful and efficient. For example, at ygap, we have reduced all domestic travel to just essential travel and all industry subscriptions to only the essentials.

Keep (K) - These of course will be all the expenses that are essential to the delivery of your value proposition - the expenses you can't afford to cut. This might be your rent & utilities, product/service inputs, etc. For example, at ygap, we recognise that our staff is our most important asset and we have made all necessary adjustments to ensure that we can retain all our staff members.

A budget review like this will be crucial in a time of crisis but is actually a great practice for your business to consider integrating into its regular annual budget process.

**ACTION**

For this exercise, you will need to have your previous quarter’s income statement on hand and know your bank and cash balances at the beginning and end of that period.

**Undertake a quick cash flow health check for your enterprise for the last quarter**

- Are you cash flow positive or negative?
- What is your runway if the business environment does not improve?
- What are some of the options available that you could take to improve the cash flow situation? What would you Postpone, Eliminate, Reduce or Keep (PERK)?
Developing Scenarios
Developing Scenarios

Performance scenarios are an important planning tool for any business because they help you prepare contingencies for any situation that may arise in the future such as revenue decreases or increases, staff labour actions, and regulatory changes among others. In this case, we will look at revenue changes brought about by the COVID-19 pandemic business environment.

We will walk you through developing worst-case, normal-case, and best-case scenarios for your business that can help you adjust your operations as your business environment changes.

**Note:** The scenarios explored in this section are adopted in a COVID-19 pandemic business environment context. The key assumption is that businesses are already operating below their ordinary revenue levels due to the impact of the pandemic to the business environment.
WORST CASE SCENARIO

This is an outlook of your business that represents the worst turnout of events which could include a sharp decline in revenue (sales) or a sharp decline in production which would affect your sales figures.

Example

Nazif Organik’s worst-case scenario projects that they will be operating at 20% of their usual monthly revenues. Where they were typically bringing in $10,000 per month, this scenario assumes they are only bringing in $2,000 for the coming month resulting from the challenges of the current pandemic.

- Cash at hand/ bank at the beginning of the month: $5,500
- Expense projection for the month: $10,000

<table>
<thead>
<tr>
<th>PARTICULARS</th>
<th>CASH IN $</th>
<th>CASH OUT $</th>
<th>BALANCE $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash at the beginning of the month</td>
<td>5,500</td>
<td>5,500</td>
<td></td>
</tr>
<tr>
<td>Projected Net paid up sales (after cost of sales)</td>
<td>2,000</td>
<td>7,500</td>
<td></td>
</tr>
<tr>
<td>Salaries</td>
<td>5,000</td>
<td>2,500</td>
<td></td>
</tr>
<tr>
<td>Admin Expenses + Utilities</td>
<td>1,000</td>
<td>1,500</td>
<td></td>
</tr>
<tr>
<td>Loan Repayment</td>
<td>1,500</td>
<td>-0.00</td>
<td></td>
</tr>
<tr>
<td>Marketing</td>
<td>500</td>
<td>-500</td>
<td></td>
</tr>
<tr>
<td>Lease Costs</td>
<td>2,000</td>
<td>-2,500</td>
<td></td>
</tr>
</tbody>
</table>

Contingency measures that could be taken include:

- Renegotiate the loan repayment
- Reduce salaries
- Review office expenses
- Negotiate a reduction on your lease and explore deferring payments
- Explore other market alternatives to improve revenue
- Take additional credit - as a last resort
NORMAL CASE SCENARIO

This represents an outlook that predicts the ordinary business performance if the business environment does not improve or worsen.

Example

Nazif Organik’s normal case scenario projects that they will be operating at 40% of their usual revenues. So once again, rather than bringing in $10,000 per month, we assume they are only generating $4,000 for the coming month. Remember that while we call this ‘normal case’ - given we are developing these scenarios in light of the current pandemic, our ‘normal case’ will not reflect our normal monthly revenues but the normal or mid-range expectation we have for how our revenue will be impacted as a result of the current climate.

- Cash at hand/ bank at the beginning of the month - $ 5,500
- Expense projection for the month - $ 10,000

<table>
<thead>
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<tbody>
<tr>
<td>Cash at the beginning of the month</td>
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<td>Projected Net paid up sales (after cost of sales)</td>
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</tr>
<tr>
<td>Admin Expenses + Utilities</td>
<td>1,000</td>
<td>1,500</td>
<td>1,500</td>
</tr>
<tr>
<td>Loan Repayment</td>
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<td>Marketing</td>
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</tr>
<tr>
<td>Lease Costs</td>
<td>2,000</td>
<td>-500</td>
<td>-500</td>
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Contingency measures that could be taken include:

- Renegotiate the loan repayment
- Reduce salaries
- Review office expenses
- Negotiate a reduction on your lease and explore deferring payments
- Explore other market alternatives to improve revenue
- Take additional credit - as a last resort
BEST CASE SCENARIO

This represents an outlook that predicts an optimistic performance if the business environment improves.

Example

Nazif Organik’s best-case scenario projects that they will be able to generate 70% of their usual revenues, bringing in $7,000 for the coming month. Again, note here that, even in our best-case scenario, we are projecting a decrease to our normal revenues. If we were not in the midst of a global pandemic, hopefully your best-case scenario would show an increase in revenues!

- Cash at hand/bank at the beginning of the month - $5,500.
- Expense projection for the month - $10,000.

Contingency measures that could be taken include:

- Renegotiate the loan repayment
- Review office expenses
- Explore other market alternatives to improve revenue
- Take additional credit - as a last resort

<table>
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<th>CASH OUT $</th>
<th>BALANCE $</th>
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<tbody>
<tr>
<td>Cash at the beginning of the month</td>
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<td>5,500</td>
<td></td>
</tr>
<tr>
<td>Projected Net paid up sales (after cost of sales)</td>
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<tr>
<td>Salaries</td>
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<td>2,500</td>
<td></td>
</tr>
<tr>
<td>Admin Expenses + Utilities</td>
<td>1,000</td>
<td>1,500</td>
<td></td>
</tr>
<tr>
<td>Loan Repayment</td>
<td>1,500</td>
<td>-0.00</td>
<td></td>
</tr>
<tr>
<td>Marketing</td>
<td>500</td>
<td>-500</td>
<td></td>
</tr>
<tr>
<td>Lease Costs</td>
<td>2,000</td>
<td>2,500</td>
<td></td>
</tr>
</tbody>
</table>
How to Improve Cash Flow
How to Improve Cash Flow

After running cash flow simulations for these three different scenarios, you should have a clear idea of where you need to take action to improve your financial runway.

Some of the contingency measures that you may want to explore include:

1. **Push for cash payments** – The sooner your customer pays for products/services delivered, the sooner your business has money to pay for your expenses. You should aim to balance the sustainability of your value proposition (credit sales may be an attractive feature for your customers!) with the need to improve liquidity (your available cash). The pandemic will also likely be putting strain on your customers’ cash flows so it is safest to encourage them to pay as soon as possible to avoid outstanding debts.

2. **Extend your credit cycle** – Negotiate with your suppliers to allow for more time for you to pay invoices and meet your other financial obligations. Extending this period allows you extra time to acquire the cash you need to cover the expense. This, again, should be balanced with the business' ability to maintain good working relationships with suppliers under this arrangement.
3. **Negotiate discounts** - Discuss with your biggest suppliers whether they would be open to a discount to enable you to continue sourcing from them - or if they would offer it in return for signing on to a longer term agreement.

4. **Explore 'just in time' inventory.** Where possible, buy inputs/stock only when needed to avoid locking up cash in inventory. Making special arrangements with your suppliers will help avoid delays in production or service delivery (noting that this may be difficult during COVID-19 due to supply chain and logistical challenges). Also consider selling old stock at a discount to free up cash.

5. **Explore 'just in time' production** - Where possible, the business should aim to produce just what has been ordered or is within the projected demand for the planning period.

6. **Open lines of credit** such as overdraft facilities to meet the occasional cash flow gap.

7. **Access a loan product** for a long-term, cheaper credit option.

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**ACTION**

1. Take some time now to develop your worst-case, normal-case, and best-case scenarios.
2. Propose a few contingency measures you could take to respond to each scenario.

Source: https://articles.bplans.com/how-to-manage-cash-flow-in-a-crisis/
Conclusion
Conclusion

"That which does not kill us makes us stronger.'
- Fredrich Nietzsche

As startup founders who have taken on the (already uncertain!) journey of entrepreneurship, none of you could have anticipated that your path would include facing what is likely to be one of the world’s worst recessions. However, just like the Great Depression and the 2008 Global Financial Crisis, this too shall pass! And the businesses that come out the other end thriving will be those that are able to react quickly, are prepared for various scenarios and are able to leverage this time to put in place strong business planning processes that will serve them well through this crisis and well into the future.

We hope this toolkit has helped you take those first critical steps towards understanding your cash flow, how you can use that knowledge to make accurate forecasts, and identify the immediate actions you can take to ensure your business’ financial survival.
Start-ups and small businesses are being hit hard by measures taken in response to the COVID-19 outbreak. For ygап, having worked to support the growth of such businesses since 2008, this is a time not to hit pause.

We have mobilised an organisational response that is demand-driven, agile, localised and supported by our global team. This response represents a temporary transition for ygап – from backing local change, to backing local survival.

Globally, we have developed a suite of resiliency-focused entrepreneurial resources to support entrepreneurs and their ventures through this challenging time, the ygап Resiliency Series.

Recognising that a crisis like this requires collaboration and solidarity, we’ve made these resources open-source to ensure that it helps as many ventures as possible. Please feel free to use and share these resources within your own networks.
Who is ygap

ygap is an international development organisation that supports early-stage social impact ventures with locally-led solutions to local problems. We believe in the power of entrepreneurship as an effective and sustainable way to provide opportunities for people to lift themselves out of poverty and disadvantage.

We find, accelerate and support the growth of impact ventures led by local entrepreneurs who deeply understand the unique challenges of their communities and are best placed to develop solutions. We currently support ventures across Africa, South Asia, the Pacific Islands and Australia. ygap has offices and local teams that lead our programs in each area that we work.

If you have any further questions about our COVID-19 response or our work, please contact our Head of Global Programs, Simon Lee at simon.lee@ygap.org.