

# CASH FLOW

## *The lifeblood of your business*

Cash flow is the lifeblood of a business and critical in the growth and well being of a business. Small business owners must plan and prepare for future events and market changes. The most important aspect of planning is effective cash flow management.

Cash flow serves several purposes. First, it is used for meeting normal cash obligations such as paying bills. Second, it is held as a precautionary measure for unanticipated problems. Third, it is held for potential investment purposes. The term "cash" refers to those assets that are liquid and have immediate cash redemption value such as cash and checks.

The operating cycle is defined as the system through which cash flows from the purchase of inventory through the collection of accounts receivable. It measures the flow of assets into cash and is a business stopwatch.

For example, the operating cycle may begin with cash and inventory on hand. A company purchases additional inventory on 30 day credit terms to sell. When the inventory is sold, cash or account receivables (sales on credit terms) are generated. The account receivables cannot be used to make payroll and pay bills until collected. The company uses the cash from sales and collections of account receivables to pay for the inventory purchased on credit. Now the cash has completed its flow through the operating cycle and is ready to begin again.

Cash flow analysis shows whether your daily operations generate enough cash to meet your business obligations. It also indicates how major cash outflows relate to major cash inflows. It will tell you if inflows and outflows result in a positive cash flow from operations or in a net drain of funds. Early identification of cash related problems will facilitate better control of cash flows and will allow adequate time to plan and prepare for the growth of your business.

The development of a cash reserve account will enable you to plan expenditures for the following month. A monthly cash-flow projection helps to look at available funds and compare actual figures to past months. Project your monthly cash flow to identify and eliminate deficiencies or surpluses in cash. If deficiencies are found, financial plans must be altered to provide more cash. If excess cash is revealed, it might indicate excessive borrowing or idle money that could be invested. The objective is to develop a plan that will provide a well-balanced cash flow.

To achieve a positive cash flow you must have a sound strategy. Cash reserves can be increased by the collection of receivables, tightened credit requirements, method of pricing products, loans, increased sales and the timely collection of accounts receivable.

As credit and terms are tightened more customers must pay cash for their purchases, increasing the cash on hand and reducing the bad debt expense. While tightening credit may be a strategy in the short run it may not be advantageous in the long run. A liberal credit policy allows more customers the opportunity to purchase your products or services. The increase in sales with this liberal credit policy must be greater than the potential increase in bad-debt expense.

Commercial loans are often necessary to cover short-term cash flow requirements. Revolving credit lines and equity loans are common types of credit used in this situation. Remember that bank financing may not provide immediate cash resources. A sufficient lead-time will be necessary to complete the loan application and receive a final decision from the bank.

Increased sales would appear to increase cash flow, but be careful. For many companies a large portion of sales are purchased on credit. When sales increase, accounts receivable also increase, not cash. Collection terms of receivables is usually 30 days after purchase date and sales expenses are most often incurred before receivables are collected.

It is imperative to actively manage accounts receivable and quickly collect past due accounts. Revenues are lost when a firm's collection policies are not aggressive. The longer your customer's balance remains unpaid, the less likely that you will collect the full payment.

When sales rise, inventory is depleted and must be replaced. Since receivables have not yet been collected, a substantial increase in sales can quickly deplete a firm's cash reserves. By utilizing one of the many computer accounting software packages available, you can maintain this critical data in a form useful for quick management decisions.

A user friendly financial management software package and computer will enable you to review projected inflows and outflows of cash from month to month or year to year. By analyzing these projections you can see the fluctuations in cash flow and create management policies to avoid potential shortfalls.