

# Cash flows

## About cash

Cash is the money kept in the cash register or bank account; the money you use to pay bills, wages, taxes and other expenses. How you manage this cash is critical to the success or failure of your business. A business needs cash to keep going, just as a car needs petrol. Efficient cash flow management will enable you to fuel the business with sufficient liquidity to keep it running smoothly – so you get the most mileage out of each dollar.

Unless you keep a close check on your cash flow, you will probably - like a motorist who doesn't watch the petrol gauge - be stranded before long. Sooner or later most businesses come across the problem of cash - that is, having to find some money quickly (for example, on a Monday morning you suddenly realise that you require money to pay the wages for Thursday and that there is no prospect of cash coming in before that time. Or you find that unless you can pay your supplier's account of \$12,000 by the end of the month he is going to stop supply and bring your production to a halt).

You may find you cannot cover monthly expenses or finance an expansion. If you cannot get outside assistance, then your business may be forced to close. Desperate last minute appeals for cash and credit seldom work; neither do they result in a positive response; nor do they solve the basic problems, which cause cash shortage. As one expert puts it - "turning up at a bank to seek relief from an unexpected shortage of cash is hardly the way to give the bank the confidence in the managerial ability of your business".

Proper planning of your cash resources would probably have averted these problems.

## Profit is not cash

Remember that cash flow is not the same as net income. Cash flow balances do not match the amount of net profit as shown in your profit and loss accounts. This is because net profit includes non-cash items, such as depreciation etc., but the cash flow is concerned only with items that are cash, regardless of whether they are expenses or non-expenses.

In accounting, the profit is matched by taking income and deducting expenses. But in accounting the cash transactions in the business are only part of the whole equation. Accounting, which results in the calculation of the net profit, is concerned with matching income with expenses. Cash flow is concerned with matching cash coming in with cash going out. One is purely cash while the other is not. It is very important to master this fact if you are to understand what cash flow is all about.

## Cash flow is vital

It doesn't matter what business it is, when you run out of money - you're gone. How long will your suppliers keep supplying goods to you if they are not getting paid? How long will your staff remain loyal and work hard if they are not getting paid? How long are you able to keep going as the owner of the business if you are not able to take home money to pay for living costs and family expenses?

## Too successful - be in control

Many businesses flounder and then close up because they are too successful. By this we mean they grow too fast and this expansion has not kept pace with their cash flow planning. What happens is that cash is needed to purchase more stock, or to set up more premises, or buy more assets, or generate more sales. However, there are costs that still need to be met such as wages, rent, power, phones etc and it is not long before the business finds itself stretched. It is amazing how many businesses which are very profitable and growing very fast end up in liquidation. The biggest single cause is poor planning of cash.

Many small business owners fail to keep track of their cash flow because they are frightened or frustrated by the prospect of keeping a large amount of paper work. The process need not be very complex at all. Cash control is a necessary tool through which the proper balance between a healthy cash position and maximum profits can be achieved.

## Handling a cash crisis

Ever had a cash crisis? Some of the suggestions made to cope with this situation include:

- Stop buying raw materials or stock.
- Carry out an immediate stocktake including raw materials and packaging and identify which stock is readily saleable and which is out of date.
- Prepare a list of your debtors (that is, people who owe you money) - carry out urgent action to collect these.
- Prepare a list of your creditors (that is, firms to whom you owe money) and make arrangements (if possible) to delay payment of these.
- Review your immediate sales program to decide your real sales potential within the next month, 3 months or 6 months.
- Develop a plan to quit old stock immediately at the best possible prices to raise cash.
- Develop a plan to reduce your stock of raw materials and quit old and damaged materials.
- See if you are able to return any of your stocks to the supplier for credit.
- List any assets such as plant and equipment that are not in use and that can perhaps be sold for cash.
- Check your present overdraft accommodation and see if you are over the limit and if so, what can be done about it.
- Review your own personal expenditure and see if there is any possibility of reducing these costs temporarily.
- Draw up a new cash flow forecast and discuss this with your accountant and bank manager to see if a plan can be worked out to assist your temporary cash problems.



› Driving the economic development of Queensland ‹

## Further information

The following fact sheets provide further information on these issues:

- Business growth tips
- Control your costs
- Control your debt
- Financial analysis overview
- Financial ratios
- Improve your cash flow
- Profit and loss ratios