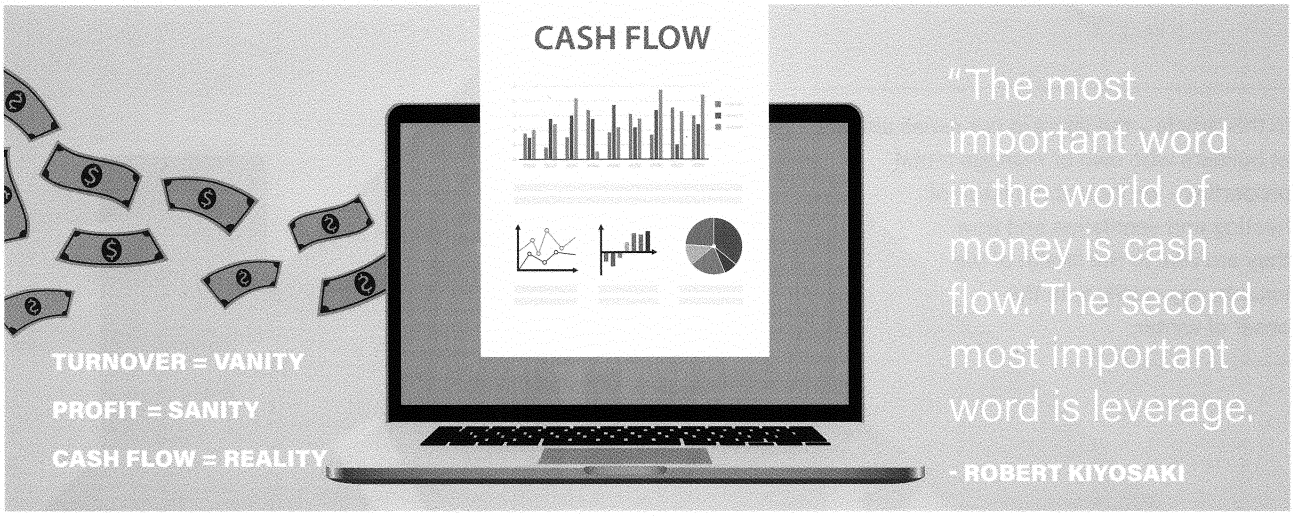


It's all about cash flow

BY SHANE STOREY

WHEN YOUR ACCOUNTANT ASKS "DO YOU KNOW WHAT IT MEANS WHEN ALL YOUR FINANCIAL STATEMENTS ARE IN RED INK?" AND YOUR RESPONSE IS "IS IT TIME TO CHANGE THE PRINTER CARTRIDGE?", THEN YOU MAY HAVE A PROBLEM!

Cash flow is the mother lode of business. But getting your hands on your cash and keeping hold of it can be difficult.

SIX RULES OF CASH FLOW

CASH FLOW SHOULD BE POSITIVE

Negative cash flow means the business is losing cash from the operations of the business, and the sustainability of the business is in jeopardy because the business is paying its bills by:

- Dipping into savings;
- Selling assets such as a vehicles or computers;
- Borrowing money from a third party, like a bank or an investor;

CASH FLOW SHOULD BE GREATER THAN PROFITS

On an income statement, not all expenses are cash. Depreciation and amortization (the practice of reducing the value of generally intangible assets, such as goodwill, to reflect their reduced worth over time) are examples of expenses which reduce profits but never have an impact on cash. Therefore, if your business has depreciation and/or amortization expenses, your profits should be smaller than your cash flow. If cash flow is smaller than your profits, check the balance sheet for:

- Ballooning accounts receivable or other non-cash current assets;
- Escalating inventory;
- A sharp decrease in accounts payable or other current liabilities;

CASH FLOW SHOULD BE MOVING IN THE SAME DIRECTION AS PROFITS

If profits are going up, cash flow should also be going up. Not only that, all going well, cash flow will be increasing at a fast or higher percentage rate than profits are increasing. A business that makes less and less on more and more will eventually go broke.

CASH FLOW IS BIGGER THAN INVESTING CASH NEEDS

A business whose cash flow is greater than it's investing cash requirement is self-sufficient and does not have to rely on the generosity of strangers, such as third-party financing called bankers and investors.

MAINTAIN A CASH RESERVE

Every entrepreneur or business owner will tell you that the unexpected will always happen. It's close to impossible to accurately predict your expenses since disaster may, and possibly will, strike at some point in your journey (usually at the most inconvenient moment). If you're able to maintain a cash reserve then you will be able to manoeuvre out of these shortfalls easily. Keep at least three to six months of basic operating expenses in a cash reserve at all times. If you need to dip into these reserves, make sure you're consistently replenishing the reserves. If you are diligent about maintaining a cash reserve you can be confident that your business will be able to survive when the unexpected occurs.

CHASE DEBTORS

Use the phone. Are you more likely to pay a creditor that calls you directly and asks to be paid personally, or the one that sends a passive request via email or envelope? It's a no-brainer who gets paid first. Take action right now. If you don't, you'll be the firm that ends up ringing clients that have already paid their other suppliers but now have no free funds to pay you.

It's your money – so don't play bank.

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