

How to Create a More Positive Cash Flow

By
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If, as many experts agree, that the golden rule of business is "cash is king," then happiness in business is a positive cash flow. Cash flow is the movement of money in and out of your business over a defined period of time (weekly, monthly, or quarterly). If cash coming into your business exceeds the cash going out of your business, your company has a *positive cash flow*. However, if your cash outflow exceeds the cash inflow, then your company has a *negative cash flow*. To create a positive cash flow, generate more cash and collect the cash in a more timely manner and at the same time, maintain or reduce your expenses.

Positive cash flow does not happen by accident; it happens because a well-defined financial management technique called "cash management" is functioning. A good cash management system helps to efficiently and effectively manage the activities that produce cash. Maintaining an optimal level of cash that is neither excessive, nor deficient is of the utmost importance. Accelerating cash inflows wherever possible is a mandatory practice. Two activities that accelerate cash inflows include invoicing customers as quickly as possible and collecting cash on past due accounts. Delaying cash outflows until they come due is a critical step in good cash conservation. Negotiating extended payment terms with suppliers also delays cash outflows. In addition, investing surplus cash to earn the highest rate of return is a good business practice.

In order to understand the magnitude and timing of cash flows, plotting cash movement, with the use of cash flow forecasts, is critical. A cash flow forecast provides you with a clearer picture of your cash sources and their expected date of arrival. Identifying these two factors will help you to determine "what" you will spend the cash on, and "when" you will need to spend it.

Your financial reporting documents should include an Income Statement, a Balance Sheet and a Statement of Cash Flows. Your "cash flow forecast" reflects the same three types of cash flow activities that appear in your Statement of Cash Flows. The three types of cash flow activities are:

- Cash Flows from Operating Activities: This is the cash flow that is generated which is the direct result of the sales of your product/services.
- Cash Flows from Investing Activities: This is the cash flow that is generated from non-operating activities, such as, investments in plant and equipment or other fixed assets.
- Cash Flows from Financing Activities: This is the cash flow that is generated from external sources--- lenders and investors.

These three types of cash flow activities are interrelated. They depend on, and affect each other. The cash flow forecast should take this into account, and provide a complete picture of where cash will come from and how it will be used for the period being forecasted. The relationships between the different cash flow activities may depend on the nature of your business, the stage of development of your business, as well as, general economic conditions, or conditions within the market or industry in which your business operates.

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Cash outflows and inflows seldom occur together. In most cases, cash inflows seem to lag behind cash outflows, leaving your business short on cash. This shortfall is your "cash flow gap." The cash flow gap is the period (number of days) between your business payment of cash for goods and services purchased, and the receipt of cash from your customers for goods or services sold. In other words, inventory days on hand + receivables collection period – accounts payable period = the cash flow gap. This interval, the cash flow gap, must be financed. Keep in mind the fact, that for each day your cash flow gap is extended, so too is the amount of interest being accrued. Even when interest rates are low, the cost of financing can add up quickly.

Here are three ways your company can narrow its cash flow gap:

1. **Stretch out your payment terms on purchases for inventory.** In most industries, payment terms are largely determined by tradition and vary from industry to industry.
2. **Shorten the collection period.** The faster your company can collect money for products and/or services sold, the smaller its cash flow gap will be.
3. **Increase inventory turnover.** The faster your company moves inventory, the less cash it needs. The key to managing inventory successfully is to continuously monitor your daily sales activity to your inventory on-hand.

Profit growth does not necessarily mean more cash on hand. Profit (or net income) is the difference between your company's total revenue and its total expenses. It measures how efficiently your business is operating. Cash flow measures your company's liquidity (the ability to pay bills and other financial obligations on time). You cannot spend profit; you can only spend cash to pay suppliers, employees, the government, and lenders.

Many small business owners have discovered that profitability does not guarantee liquidity. Over time, your company's profits are of little value if they are not accompanied by a positive net cash flow. To create a positive net cash flow, generate more cash and collect the cash in a more timely manner and at the same time, maintain or reduce your expenses. The four ways that can help your company to generate more cash, are:

1. **Increase sales by attracting new customers.** Your business cannot sustain itself without the addition of new customers. New customer acquisition is a process that combines market data with direct marketing tools to identify and reach high-potential prospects and convert those prospects into customers.
2. **Increase sales by selling additional product/services to existing customers.** It is far less expensive to generate additional business from your existing customer base than it is to generate new business from new customers. A regular review of your customers' buying history and frequency of purchases can reveal some interesting facts about your customers' buying habits.

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3. **Generate more cash from each dollar of sales.** More cash is generated because of increased profit margins made possible by increasing selling prices and reducing costs of goods sold.
4. **Reduce overhead.** Overhead costs generally include facilities, equipment, administrative and management personnel. The key is to produce a larger volume of business at a lower cost.

Ideally, during your business cycle, money flowing into your business should be greater than money flowing out of it. The buildup of a *surplus cash balance* is important because it enables you to plug cash flow gaps when necessary, to pursue expansion initiatives, and to reassure lenders and investors that your business is in good financial health.

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