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Understanding Cash Flow

CA. – October 18, 2007 - If you're opening your own auto appearance business, no doubt you plan to make a profit. Knowing how to do a cash flow analysis is an essential skill for every new small business owner; it can be the difference between being able to open a business and being able to stay in business!

Cash flow analysis provides a means for you to conduct a periodic check on your company's financial health. A projected cash flow statement estimates what the stream of money will be in coming months or years, based on a history of sales and expenses. A monthly cash flow statement reveals the current state of affairs.

A cash flow budget is your core tool for maintaining control of company finances. For example, you can show profits in a company, but still be short on cash if a customer is late on payments. While you can usually cut costs, you can't always generate income or sales. You need to know where the money is, where it's going and how to get more when you need it.

Calculating Your Cash Flow
To get a handle on the financial outlook for your dent repair and auto reconditioning business, start with your budget; which projects profits or losses by looking expected income and expenses. (If you need a hand with budgeting, feel free to call The Ding King for personal assistance for proper planning.)

For our purposes, the most important use of the budget is that its numbers can be used to help anticipate cash flow needs, which is essential to keeping a small business operating smoothly.

The basic elements of cash flow are:

- Starting cash - This is your starting balance - what you have on hand at the beginning of each month.
- Cash in -This is all cash received during the month, including sales, paid receivables, interest or cash from sales of assets or stock.
- Cash out - Includes all fixed and variable expenses.

- Ending cash - This is your ending balance. Add starting cash to cash in for total cash, and then subtract cash out.

Let's say you started the month with $3,500. You brought in $2,500 in sales and $500 in paid receivables. You paid out $1,500 in rent, $250 in supplies, and $1,750 for wages and owner's draw - for a total of $3,500 in expenses. Your ending balance is $3,000.

While you did show some sales, your monthly cash flow would be -$500. To survive, you want positive cash flow, which means taking in more than you are spending. Positive cash flow gives you forward motion to build and grow.

Even a small lag in sales or an outstanding bill can make a dramatic impact on cash flow, but you won't know that without your cash flow budget. At the end of every month, compare actual business sales with estimated cash flow and hold them up against your master budget.

If they are out of sync, consider the cause. Maybe you didn't factor in auto reconditioning supplies or labor. Cut back on cash out where you can, and adjust monthly cash flow projections to more realistically meet your needs.

Cash Flow Management Practices
Good cash flow management means you can anticipate when your cash flow needs will occur. Your cash flow budget will help you predict what's coming, but you have to be diligent in daily record keeping and reporting of cash in and cash out.

The following steps can help you monitor cash flow:

- Use pre-numbered cash receipts and account for all receipts
- Deposit checks daily
- Send customer invoices within two days
- Collect receivables within 60 days
- Take advantage of cash discounts
- Use pre-numbered checks for all disbursements

A good cash flow manager should be ready to meet challenges. For example, if your company has a history of slow summer sales, you may have trouble meeting payroll in those months. If you have periodically reviewed your cash flow budget and projections, you will be prepared for the crunch with additional sources of cash, and will have established good relationships with creditors and banks should a short-term loan be necessary.

Here are some ways to project and meet cash flow needs:

- Anticipate payroll
- Anticipate outstanding debt payments
- Set money aside for expansion, emergencies and opportunity purchases
- Use short-term financing when necessary
- Establish a line of credit with a bank to avoid making bad decisions in a cash panic

Cash Flow: Offer Customers Credit with Caution
You may find yourself in a situation where offering credit is necessary for doing business, or you may decide to accept credit as a way to generate more business. Of the two types of credit, trade and consumer, consumer is the easiest to offer and maintain.

Consumer credit involves the acceptance of major credit and debit cards. To offer this service, you simply approach your bank and set up a program. The bank takes a small fee or percentage on each charge and in exchange, it accepts the credit risk. Trade credit is offered by the business itself. In some industries, such as manufacturing and wholesaling, customers expect trade credit. For example, when a wholesaler ships supplies to a retail company, the accompanying invoice indicates terms of payment. Most wholesalers give the retailer 30 days to pay the bill, which amounts to 30 days of credit.

Cash Flow: How to Deal with Profit
What do I do with all this cash?
If you have managed your cash flow effectively, you should end up with extra cash. What you do with those profits should be directly related to your cash flow budget. Remember that you created this

budget to predict cash flow needs. There may be some outstanding debts ballooning in the future or inventory that needs restocking. These anticipated needs determine where and how long you can reroute cash.

Some places to put excess cash include:

- Debt service - Repaying debt should help improve cash flow even further, unless the loan's interest rate is so low you would get a better return for your money on outside investments.
- Investments - Check out the pros and cons of investment opportunities such as certificates of deposit, money market funds, sweep accounts (combined checking and investment accounts) or interest-bearing checking accounts.
- Emergency savings - Liquid cash accounts can help you over small hurdles and provide ready money for unexpected opportunities.
- Capital improvements - Putting money back into the business may be a long-term goal in keeping with your business plan and capital budget.
- Increasing wages and dividends - Salary increases can help you retain your best employees, and you may deserve a reward, too.
- Profit sharing - A benefit and an incentive for employees.