

Cash Flow: A Central Part of Your Business Plan

When tracking and planning your business objectives, it's easy to focus your analysis on two reports—the income statement and balance sheet. But one of the primary keys to your business' success relies more on how you handle the money flowing in and out of the business. The appearance of a solid profit can hide a lurking cash flow problem.

Here are practices to help you give your cash flow the attention it deserves:

Understand your cash position: Start with simply getting in the habit of monitoring your bank account activity daily to watch for mistakes or unforeseen charges. Then look at each business process that involves cash—purchasing, inventory, collections and payroll are good examples. Consider extending terms for paying vendors, establishing shorter terms for customers to pay and implementing a review process to ensure accurate payroll calculations. Also explore opportunities to turn over your inventory faster.

Create a cash flow statement forecast: With your knowledge of cash, create a forward-looking statement of monthly cash flow. It will reflect the ebbs and flows of cash throughout the year and identify times of cash crunch. You can then see the impact of changes you are making on your company's cash position.

Identify relevant ratios: There are many helpful cash flow ratios. Identify ratios that are especially helpful to your business. Have debt? Consider the cash flow coverage ratio (operating cash flow divided by debt) to help plan for scheduled debt payments. Making a lot of capital purchases? Use the free cash flow calculation (operating cash flow minus capital expenditures) to determine how much cash will be left over after the purchases.

Build in some contingencies: Most businesses experience seasonality. Understanding your business cycles can help you strategically manage cash in high cash months to cover shortfalls that come in low cash months. Set up a line of credit so it's available in the case of an emergency, or as a bridge during short-term liquidity needs. A line of credit charges interest only when used, so it's a perfect tool to have at your disposal.

Watch for hidden cash hijackers: Oftentimes, large cash expenditures can be hidden on your income statement or balance sheet. A few examples are payments on capital purchases, debt obligations, dividends, guaranteed payments to partners and taxes. Income taxes, when not accounted for correctly, can cause a twofold problem—a large lump sum that is due in a short amount of time, plus a larger obligation to account for going forward. Don't wait until the end of the year to project your tax provision.

Appoint someone to manage cash: As with many business processes, important details can fall through the cracks if there is not clear accountability as to who is responsible for the task. So assign yourself or someone you trust to manage the company's cash flow.



When businesses fail, it's usually because they run out of money. By making cash flow a central part of your business plan, you greatly reduce this risk.