



Article 30

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## **Cash Flow: Timing is everything**

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Ever had a friend who seemed to have it all – high-paying job, nice car, beautiful home and plenty of toys to fill the garage? But at the end of the month, your successful friend doesn't seem to have \$10 to his name. Turns out he has been pouring all those earnings into the house, the car and the toys. Perhaps he can afford them all, but he could certainly use a lesson in cash flow management.

This illustrates a critical lesson for business owners: profitable companies can go bankrupt. It may seem counterintuitive – a business that lands in the black can simultaneously be putting itself out of business. But business owners who fail to manage cash flow can find themselves much like that friend – with positive earnings but no cash to pay bills.

The first step is to create a cash budget – a powerful financial tool that helps you monitor and manage cash inflows and outflows, plan for excesses and deficiencies of cash, and decide when you need to borrow and when you can pay back loans. Having a better handle on the collection and payment of cash can forestall the kind of cash crises that plague many small businesses and can lead to bankruptcy, even if the business is profitable.

While it is important to budget for sales, it is critical to budget for cash collections – when you will be paid for the goods and services you provide. Equally important is to budget for cash payments – when your vendors or suppliers are required to be paid. Timing is the key: unless you operate a cash-only business, sales do not equal cash collections, and expenses do not equal cash payments. Many businesses extend credit and, thus, are paid sometime after the sale is made. Likewise, many businesses pay vendors after the goods or services have been received.

A cash budget can be created by adding all of your expected cash inflows to your bank balance at the beginning of the month, then subtracting expected cash outflows to determine how much cash will remain at month's end.

For example, let's say your company has been earning a profit, and thanks to strong recent sales, is on target to exceed last month's income. You project \$22,000 in sales this month and you started the month with \$4,000 cash in the bank.

Based on historical trends, you project that of the \$22,000 in sales, you will only receive \$12,000 since \$10,000 of it will be sold on credit. You also expect to collect \$3,000 the business is still

owed from last month’s sales. Based on this, you expect your cash receipts – everything that represents an inflow of cash – to be \$15,000.

During the month you must pay \$12,000 for the purchase of new inventory and \$8,000 for wages. These cash disbursements - everything that represents a cash payment – amount to \$20,000.

Cash Excess/Deficiency	
Cash available beginning of the month	\$ 4,000
Add receipts	\$ 15,000
Total cash available	\$ 19,000
Less disbursements	\$ 20,000
Excess (deficiency) of cash, month end	\$ (1,000)

Given this scenario, your business would actually be running a cash deficit of \$1,000 and you will need to scramble to find cash to pay bills. Remember that this is the same business that is earning a net profit before taxes of \$3,000 on sales of \$23,000 less expenses of \$20,000.

If you already have an accountant, you should sit down with her or him to talk about building a set of budgeted financial statements. If you’re just getting started and want to learn more about the basics of cash flow, there are a number of small business development resources out there ready to help. Organizations that offer classes and workshops include the Small Business Development Center Network [www.nmsbdc.org](http://www.nmsbdc.org), WESST Corp ([www.wesst.org](http://www.wesst.org)) and SCORE ([www.score.org](http://www.score.org)).

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*Finance New Mexico is an initiative of the New Mexico Small Business Investment Corporation (NMSBIC), New Mexico Small Business Development Center (NMSBDC), Empowering Business Spirit (EBS), the New Mexico Venture Capital Association (NMVCA) and other partners to assist individuals and businesses in obtaining skills and funding resources for their business or idea. To learn more about resources available to New Mexicans, go to [www.FinanceNewMexico.org](http://www.FinanceNewMexico.org).*

