Managing Cash Flow
Young, growing companies are “cash sponges.”

A business can be earning a profit and be forced to close because it runs out of cash!

Cash management – forecasting, collecting, disbursing, investing, and planning for the cash a company needs to operate smoothly.
Five Cash Management Roles of an Entrepreneur

- Cash Finder
- Cash Planner
- Cash Distributor
- Cash Collector
- Cash Conserver
The Cash Flow Cycle

Order Goods  
Receive Goods  
Pay Invoice  
Sell Goods*  
Deliver Goods  
Send Invoice  
Customer Pays**

Day 1  15  40  
14  25  178  
218  221  230  
280  

Cash Flow Cycle = 240 days

* Based on Average Inventory Turnover:
365 days ______ = 178 days
2.05 times/year

** Based on Average Collection Period:
365 days ______ = 50 days
7.31 times/year
The Cash Budget

- A “cash map,” showing the amount and the timing of a firm’s cash receipts and cash disbursements over time.

- Predicts the amount of cash a company will need to operate smoothly.

- A helpful tool for visualizing the firm’s cash receipts and cash disbursements and the resulting cash balance.
Preparing a Cash Budget

- Determine a Minimum Cash Balance
- Forecast Sales
- Forecast Cash Receipts
- Forecast Cash Disbursements
- Estimate End-of-Month Cash Balance
Determine a Minimum Cash Balance

- Remember Goldilocks, the Three Bears, and the porridge:
  - Not too much...
  - Not too little...
  - but a cash balance that’s just right ... for you!
Forecast Sales

- The *heart* of the cash budget
- Sales are ultimately transformed into cash receipts and cash disbursements.
- Prepare three sales forecasts:
  - Most Likely
  - Pessimistic
  - Optimistic
Sales Forecast for a Start-Up

Example:

Number of cars in trading zone 84,000
x Percent of imports x 24%
= Number of imported cars in trading zone 20,160
Number of imports in trading zone 20,160
x Average expenditure on repairs x $485
= Total import repair sales potential $9,777,600
Total import repair sales potential $9,777,600
x Estimated market share x 9.9%
= Sales estimate $967,982
Forecast Cash Receipts

- Record all cash receipts when actually received (i.e., the cash method of accounting).
- Determine the collection pattern for credit sales; then add cash sales.
Collecting Delinquent Accounts

Probability of Collection

<table>
<thead>
<tr>
<th>Number of Delinquent Payments</th>
<th>Probability of Collection</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>93.80%</td>
</tr>
<tr>
<td>2</td>
<td>85.20%</td>
</tr>
<tr>
<td>3</td>
<td>73.60%</td>
</tr>
<tr>
<td>6</td>
<td>57.80%</td>
</tr>
<tr>
<td>9</td>
<td>42.80%</td>
</tr>
<tr>
<td>12</td>
<td>23.60%</td>
</tr>
<tr>
<td>24</td>
<td>13.60%</td>
</tr>
</tbody>
</table>
Forecast Cash Disbursements

- Start with those disbursements that are fixed amounts due on certain dates.
- Review the business checkbook to ensure accurate estimates.
- Add a cushion to the estimate to account for “Murphy's Law.”
- Don’t know where to begin? Try making a daily list of the items that generate cash and those that consume it.
SMALL BUSINESS FINANCE

- **Start-up Budget**
  - Personnel (costs prior to opening)
  - Legal/professional fees
  - Occupancy (buying and/or leasing)
  - Licenses/permits
  - Equipment
  - Insurance
  - Supplies
  - Advertising/promotions
  - Inventory
SMALL BUSINESS FINANCE

- **Operating budget**
  - Insurance
  - Rent
  - Loan payments
  - Advertising/promotion
  - Legal/accounting
  - Supplies
  - Salaries/wages
  - Utilities
  - Taxes
  - Repairs/maintenance
Estimate End-of-Month Balance

- Take Beginning Cash Balance...
- Add Cash Receipts...
- Subtract Cash Disbursements
- Result is Cash Surplus or Cash Shortage (Rpay or Borrow?)
The “Big Three” of Cash Management

- Accounts Receivable
- Accounts Payable
- Inventory
About 90% of industrial and wholesale sales are on credit, and 40% of retail sales are on account.

Recent survey of small companies across a variety of industries found that 77% extend credit to their customers.

Remember: “A sale is not a sale until you collect the money.”

The goal with accounts receivable is to collect your company’s cash as fast as you can.
**Beating the Cash Crisis**

**Accounts Receivable**

- Establish a firm credit-granting policy.
- Screen credit customers carefully.
- When an account becomes overdue, take action *immediately*.
- Add finance charges to overdue accounts (check the law first!).
- Develop a system of collecting accounts.
- Send invoices promptly.
Beating the Cash Crisis

Accounts Payable

- Stretch out payment times as long as possible **without damaging your credit rating**.
- Verify *all* invoices before paying them.
- Take advantage of cash discounts.
- Negotiate the best possible terms with your suppliers.
- Be honest with creditors; avoid the “the check is in the mail” syndrome.
- Schedule controllable cash disbursements to come due at different times.
- Use credit cards wisely.
Beating the Cash Crisis

Inventory

- Monitor it closely; it can drain a company's cash.
- Avoid inventory “overbuying.” It ties up valuable cash at a zero rate of return.
- Arrange for inventory deliveries at the latest possible date.
- Negotiate quantity discounts with suppliers when possible.
Avoiding the Cash Crunch

- Consider bartering, exchanging goods and services for other goods and services, to conserve cash.

- Trim overhead costs. For example:
  - Lease rather than buy
  - Avoid nonessential cash outlays
  - Negotiate fixed loan payments to coincide with your company’s cash flow
Avoiding the Cash Crunch

(continued)

- **Trim overhead costs. For example:**
  - Buy used equipment
  - Hire part-time employees and freelancers
  - Develop an internal security system
  - Devise a method for fighting check fraud
  - Change shipping terms
  - Switch to zero-based budgeting

- **Keep your business plan current**

- **Invest surplus cash**
# Stereo City Income Statement

## INCOME:

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
<th>% of Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Sales</td>
<td>$450,000</td>
<td>100.00%</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>$270,000</td>
<td>60.00%</td>
</tr>
<tr>
<td>GROSS PROFIT ON SALES</td>
<td>$180,000</td>
<td>40.00%</td>
</tr>
</tbody>
</table>

## EXPENSES:

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
<th>% of Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selling Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td>$12,000</td>
<td>2.67%</td>
</tr>
<tr>
<td>Delivery and Freight</td>
<td>$10,000</td>
<td>2.22%</td>
</tr>
<tr>
<td>Sales Salaries</td>
<td>$25,000</td>
<td>5.56%</td>
</tr>
<tr>
<td>Miscellaneous Selling Expenses</td>
<td>$1,000</td>
<td>0.22%</td>
</tr>
<tr>
<td>Administrative Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Licenses</td>
<td>$150</td>
<td>0.03%</td>
</tr>
<tr>
<td>Insurance</td>
<td>$2,400</td>
<td>0.53%</td>
</tr>
<tr>
<td>Nonsales Salaries</td>
<td>$38,000</td>
<td>8.44%</td>
</tr>
<tr>
<td>Payroll Taxes</td>
<td>$6,300</td>
<td>1.40%</td>
</tr>
<tr>
<td>Rent/Mortgage</td>
<td>$12,400</td>
<td>2.76%</td>
</tr>
<tr>
<td>Utilities</td>
<td>$6,000</td>
<td>1.33%</td>
</tr>
<tr>
<td>Legal Fees</td>
<td>$1,500</td>
<td>0.33%</td>
</tr>
<tr>
<td>Depreciation</td>
<td>$42,000</td>
<td>9.33%</td>
</tr>
<tr>
<td>Miscellaneous Administrative Expenses</td>
<td>$500</td>
<td>0.11%</td>
</tr>
<tr>
<td>TOTAL EXPENSES</td>
<td>$157,250</td>
<td>34.94%</td>
</tr>
</tbody>
</table>

Fig. 17-2a
### Stereo City Income Statement (cont.)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
<th>% of Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>INCOME FROM OPERATIONS</td>
<td>$22,750</td>
<td>5.06%</td>
</tr>
<tr>
<td>OTHER INCOME</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Income</td>
<td>300</td>
<td>0.07%</td>
</tr>
<tr>
<td>OTHER EXPENSES</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Expense</td>
<td>15,000</td>
<td>3.33%</td>
</tr>
<tr>
<td>NET PROFIT (LOSS) BEFORE TAXES</td>
<td>8,050</td>
<td>1.79%</td>
</tr>
<tr>
<td>INCOME TAXES</td>
<td>3,220</td>
<td>0.72%</td>
</tr>
<tr>
<td>NET PROFIT (LOSS) AFTER TAXES</td>
<td>4,830</td>
<td>1.07%</td>
</tr>
</tbody>
</table>

**Note:**

Cash Flow From Operations Equals
Net Profit or Loss After Taxes Plus
Depreciation

$46,830

Fig. 17-2b
## Stereo City Balance Sheet

### ASSETS

<table>
<thead>
<tr>
<th>Current Assets:</th>
<th>Percent of Total Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash</strong></td>
<td>$3,500</td>
</tr>
<tr>
<td><strong>Accounts Receivable</strong></td>
<td>12,000</td>
</tr>
<tr>
<td><strong>Inventory</strong></td>
<td>125,000</td>
</tr>
<tr>
<td><strong>Prepaid Expenses</strong></td>
<td>5,000</td>
</tr>
<tr>
<td><strong>Short-term Investments</strong></td>
<td>10,000</td>
</tr>
<tr>
<td><strong>Total Current Assets</strong></td>
<td>155,500</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fixed Assets:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Building</strong></td>
<td>150,000</td>
</tr>
<tr>
<td><strong>Equipment</strong></td>
<td>25,000</td>
</tr>
<tr>
<td><strong>Leasehold Improvements</strong></td>
<td>20,000</td>
</tr>
<tr>
<td><strong>Other Fixed Assets</strong></td>
<td>15,000</td>
</tr>
<tr>
<td><strong>Gross Fixed Assets</strong></td>
<td>210,000</td>
</tr>
<tr>
<td><strong>Less: Accumulated Depreciation</strong></td>
<td>42,000</td>
</tr>
<tr>
<td><strong>Net Fixed Assets</strong></td>
<td>168,000</td>
</tr>
</tbody>
</table>

| **Total Assets**                     | 323,500                 | 100.00%                |

---

Fig. 17-3a